12/29/83 U7475-3 A

ECONOMIC OUTLOOK USA

AUTUMN 1983
Vol. 10 No. 4

A quarterly publication of the
SURVEY RESEARCH CENTER
Institute for Social Research
THE UNIVERSITY OF MICHIGAN

F. Thomas Juster
Whither the Recovery?
Richard T. Curtin
Consumer Optimism Maintained at Record Level
Richard E. Barfield
Results from the August NABE Survey
Victor Zarnowitz
Some Lessons from Research in Macroeconomic Forecasting
Arce and Torres
The Effects of Cultural Assimilation and Education on Mexican American Workers' Earnings
Author Index to Volume 10 (1983)

ECONOMIC OUTLOOK USA (USPS 330-690)
AUTUMN 1983 Vol. 10 No. 4

Published Quarterly by the
SURVEY RESEARCH CENTER
THE UNIVERSITY OF MICHIGAN
426 Thompson Street
P.O. Box 1248
Ann Arbor, Michigan 48106

EDITOR'S NOTE:

ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis in this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

The opinions expressed in this publication represent those of individual authors and do not necessarily reflect the views of the Survey Research Center or The University of Michigan. The editor, as a matter of policy, makes no attempt to reconcile divergent opinions.

SUBSCRIPTIONS:

Regular Subscribers, $27.00 U.S. per year
Academic Subscribers, $13.00 U.S. per year (available to *individual faculty and students* only)

Quantity subscriptions are available at substantial discounts. For 1-99 subscriptions, contact the Secretary at the Survey Research Center address (phone: 313—763-5169). Subscribers to 100 or more copies may use their own imprint on the front cover and may use the back cover for a message to customers, executives, and others. Direct inquiries to the Executive Editor at the Survey Research Center (phone: 313—763-5169).

EDITOR: F. Thomas Juster
EXECUTIVE EDITOR: Richard Barfield
SECRETARY-TREASURER: Nellie Beaubien

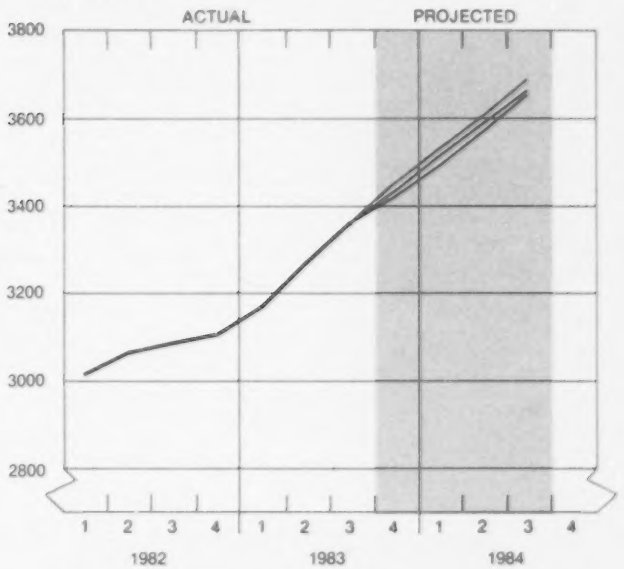
Editorial Board:
Richard Barfield
Richard T. Curtin
F. Thomas Juster
Paul W. McCracken
James N. Morgan
Burkhard Strumpel
Victor Zarnowitz

© 1983 by The University of Michigan. Second-class postage paid at Ann Arbor, Michigan. **Postmaster:** send address changes to ECONOMIC OUTLOOK USA, at the address given above. Printed in the U.S.A.

ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT

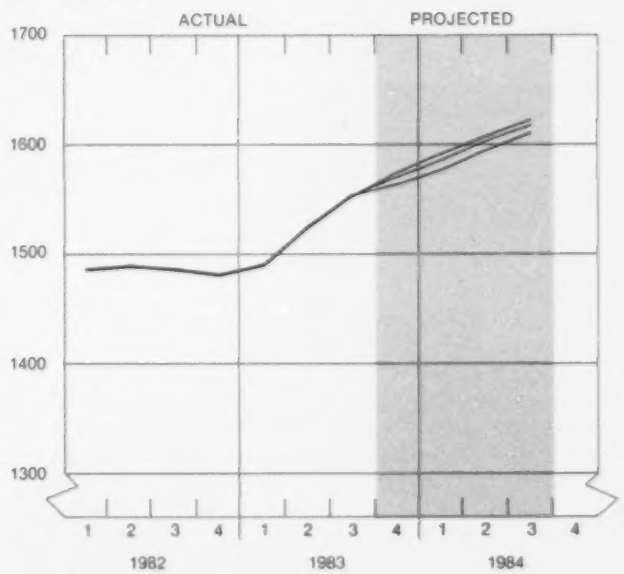
IN CURRENT DOLLARS
Billions of Dollars



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Whither the Recovery?

F. Thomas Juster
Director, Institute for Social Research
Professor of Economics
The University of Michigan

Now that the economic recovery is on a path with more growth than expected and no obvious short-term pitfalls, analysts have turned their attention to questions of its probable vigor and duration. The biggest question mark about both issues stems from the behavior of nominal and real interest rates, which after declining from their extreme peaks have continued to hang at disturbingly high levels.[1] For most observers, the question marks relate more to 1985 and beyond than to next year, since the potential clash between tight money policies and loose fiscal policies tends to be minimized as long as the economy has a large amount of slack.

Not only are interest rates abnormally high now, but it is widely believed by much of the financial community and the public that they are much more likely to rise than fall from here on out. If that were to be the case, it is easy to foresee the probable consequences: rapidly rising interest rates must eventually choke off the recovery (as they did in 1981) because of their impact on business and consumer spending behavior. Given the depth of the recent recession, a weak or aborted recovery raises the spectre of a sluggish real growth trend and an unemployment rate that starts at eight-plus percent during the next recession.

Why Are Rates So High?

To serious macroeconomists, interest rates are high primarily because of the enormous overhang of present and projected federal budget deficits that stretch as far as the eye can see at levels which are totally out of line with U.S. historical experience.

Not everyone agrees with this interpretation, especially those with some political role. Certainly, there is no automatic link between federal deficits and interest rates such that high levels of the one will cause high levels of the other. In fact, high deficit levels in the past have often been associated with *low* interest rates, simply because our largest historical deficits have always been a consequence of recession periods, when tax receipts decline automatically as personal and corporate incomes decline, while expenditures rise automatically with unemployment compensation and other cyclically sensitive outlays. But recession periods are also characterized by weak private loan demand in both the household and business sectors, hence usually by low, and typically declining, interest rates.

The current deficit problem, however, is not primarily a cyclical phenomenon. Of the roughly $200 billion deficit forecast for the current fiscal year, perhaps half is a consequence of the cyclically depressed state of the economy, while the other half is structural.[2] And while the cyclical part of the deficit is projected to decline in future years, the structural part is scheduled to grow substantially under current law, while the total is projected to show moderate increases. It is the spectre of high and rising *structural* deficits that panics the financial markets; these structural deficits can only be eliminated by policy changes on the spending or revenue sides of the budget.

Politics and the Deficit

The political impasse over the deficit has been discussed ad naseum in the financial press, and there is little to be added. The administration seems adamant about the need to increase defense spending rapidly, and in their opposition to any action that threatens to undo part of the package of tax cuts that forms the centerpiece of its economic program. The Congress seems equally adamant in its opposition to further cuts in the entitlement part of the budget or in the nondefense discretionary part. As long as nothing imminent happens to threaten the recovery, it seems a reasonable guess that the principal political actors will simply let things alone for a year until after the 1984 elections, perhaps hoping that the problem will solve itself one way or another or at least will not get any worse.

There are still forces at work trying to change this impasse. Federal Reserve Board members, on most occasions when they talk about current economic policy, invariably point to the problems posed by both current, and more pointedly, future deficits that cannot be plausibly fitted into any healthy recovery scenario. Congressional budget committee spokesmen have repeatedly made the same point. The Chairman of the President's Council of Economic Advisers has noted the potential threat to the recovery resulting from the deficit problem, particularly the threat to a vigorous capital spending boom, and has directly and indirectly suggested that tax increases have an essential part to play in solving that problem. But other administration spokesmen—the Secretary of the Treasury, for example—appear to feel that the deficit really isn't a problem, and that it's simply bad theory or poor econometrics to argue that something has to be done. The theory which suggests that deficits really aren't a problem appears to be that there isn't any demonstrated causal link between deficits and high interest rates, and that analytically government borrowing has the same effects on behavior as taxes—propositions that would find little support among macroeconomists of any persuasion.

[1]During a normal recovery, interest rates tend to decline during the early and middle stages of expansion and then rise, often sharply, in the late stages. Given the sharp decline in both the actual and expected inflation rates, the decline in interest rates, especially long-term rates, has been less than normal.

[2]The structural part of the deficit is not a simple unambiguous number. Conceptually, it is the difference between government revenues and expenditures under conditions of "full" employment, which can be plausibly defined as anywhere between four- and six-plus percent unemployment.

The Role of Economic Knowledge

An interesting sideline to the ongoing discussion is the role of economic knowledge in the formulation of public policy. The theory that originally underpinned the administration's economic policy was that substantial and permanent tax cuts would have sufficiently benign effects on the economy so that we could accommodate rising defense expenditures, provided that we got nondefense outlays under better control. The tax cuts, both personal and corporate, were thought to have the effect of greatly increasing incentive to work and save, hence producing or facilitating a larger rate of growth of real output. Thus the policy would result in the best of all possible worlds—a greatly expanded saving and investment performance that would promote increased real growth, increased work incentive that also promoted real growth, a smaller and more efficient public sector, a lower inflation rate (assuming appropriate monetary policy to be followed), little or no deficit problem, and so forth.

All of these benefits were of course to be obtained after some adjustment period, but the supply-siders argued that the adjustment period would be relatively short and relatively painless. It has turned out to be neither, and some of the originally promised outcomes have disappeared from sight. Still, if you were to ask a convinced supply-sider how things were going given original expectations, you would probably be told that things were roughly on course but that it might take a little more time than originally thought.

In sharp contrast, if you were to ask virtually anybody else in the economics professon how things were going, you would find sharp disagreement with current policy and a good deal of uniformity in responses. Most people would give the administration program credit for bringing down the inflation rate rather more sharply than would have been expected; most would give the program credit for reining in the growth of entitlements and curtailing the growth rate of nonmilitary federal spending generally; and many would say that the emphasis on deregulation and freeing up the market has resulted in more gain than loss. But most economists would also say that the recent recession, double-digit unemployment, and the looming budget deficits were a clear and predictable consequence of administration policy, that the current high levels of interest rates are an equally clear, and equally predictable, result of that policy, and that the hoped for gains in savings, investment, work effort and thus real growth are simply illusory and should never have been expected.

What has all this to do with using economic knowledge? Quite a lot, in my view. While there are numerous and sharp disagreements among economists as to how the macroeconomy works, and as to the importance of various forces in determining microeconomic decisions like working and saving, there is a well-defined body of knowledge and widespread agreement on a number of the relevant issues. For example, virtually all serious professionals would agree that changes in real after-tax wage rates have only a small influence on labor supply for the principal wage earner in a family but a larger influence on the labor supply of secondary earners. To put the matter differently, no significant body of professional opinion seriously believes that labor supply can be greatly changed by changes in real earnings, hence any expectation that tax cuts would greatly expand the supply of labor must have been rooted in hopes and dreams rather than in serious analysis.

There is less agreement on the likely response of saving to changes in after-tax rates of return. The bulk of opinion would support the proposition that not much effect was to be expected, and that even the direction of the effect is ambiguous—higher rates of return on saving being just as likely to *reduce* current saving (by making it easier to achieve certain fixed saving goals, like retirement income) as to *expand* current saving because it makes saving more attractive relative to spending. But we clearly have less firmly tested knowledge here, and some professional support could certainly be found for an optimistic view of the impact of tax cuts on saving. Even so, those familiar with the state of knowledge in this area could not be very confident about predicting a large and positive impact of rates of return on saving: anyone who holds that view has to find a way to reconcile it with a good deal of historical evidence that looks flatly contradictory.[3] And the behavior of saving rates during recent quarters certainly gives no comfort to those expecting a positive impact of policy changes on saving: despite the reductions in tax rates accompanying the ERTA, the loosening of the rules governing IRAs, and higher real returns on assets, the saving rate appears to be hovering around the four percent level—substantially less than its long-term trend value and lower than at any time during the past few decades.[4]

The fact of the matter seems to be that the administration's current economic policy was put into place with little or no concern about its consequences as judged by the weight of professional opinion. This is not a matter of liberal versus conservative policy preferences—people with all shades of political preferences are represented in the consensus professional view. However, the administration appears to believe that there is no credible scientific evidence about how the economy or individual parts of it behave, and thus that one opinion is as good as another when it comes to formulating policy. Given that belief, you might as well take the opinion you like politically, rather than the one you don't like. And amateurs and anecdotes are likely to be given as much weight as professionals and generalizable knowledge.

Alternative Scenarios

The upshot is that the future of the recovery depends largely on the willingness of the administration to come to some accomodation with its critics. No doubt a retreat in Congressional opposition to the curtailment of some of the entitlement programs is an appropriate part of any solution, especially in regard to health care entitlements. Meeting the future deficit problem with further curtailment of nondiscretionary civilian outlays, to which the Congress seems strongly opposed, is an unlikely bet—that sector is small to

[3]Two such pieces of evidence are the historic constancy, over roughly a century, of the relation between personal saving and personal income, which suggests that personal saving behavior is very hard to change in the U.S., and the behavior of saving in the late 1970s, when real after-tax rates of return for most households rose dramatically (with the appearance of money market funds offering interest rates that were two or three times as high as the rates that had been customary before then). Aggregate saving did not respond at all to this event, which represented a dramatic change in the rate of return available to most households.

[4]One should be cautious about statements relating to the level of the current personal saving rate. There is a long history of such preliminary estimates being revised upward after a few years when better benchmark data become available.

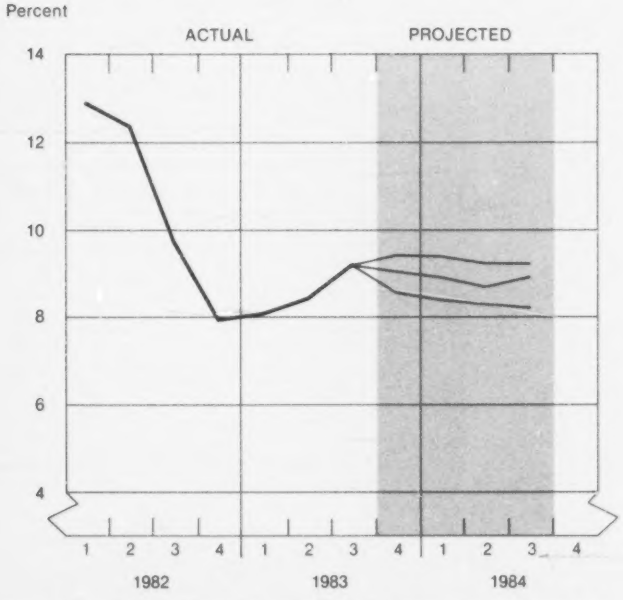
begin with and has already been sharply reduced in real terms (and significantly reduced even in nominal dollars).

The budgetary areas where there are major potential gains to be made are the projected buildup of defense spending and the revenue side. On defense spending, the arguments are really not about economic policy, but rather between people who genuinely and strongly believe that the U.S. is well behind in its ability to meet global commitments, and those who equally genuinely and equally strongly believe that the military doesn't really know what they need to meet global commitments and will always insist on buying the most expensive toys in the arsenal of potential hardware. That argument should be settled on grounds of meeting real national security needs, and only marginally on budgetary grounds.

The revenue side is probably where there is the most to be gained, and here the administration has to retreat if there is to be any hope of sustaining a strong balanced recovery. No one likes to pay taxes: but noting a dislike for paying taxes is a very different proposition than arguing that tax increases will cause consumers or business to act differently by eroding incentives. There are numerous ways to bring about a revenue increase while doing minimum damage to any incentive effects that are thought to exist – for example, consumption taxes will do less damage to incentives than income taxes, even though they are commonly judged to be more regressive. But they are probably not much more regressive, and they might be a politically more acceptable solution than undoing part of the (ill-conceived, in my judgment) income tax cuts of recent years.

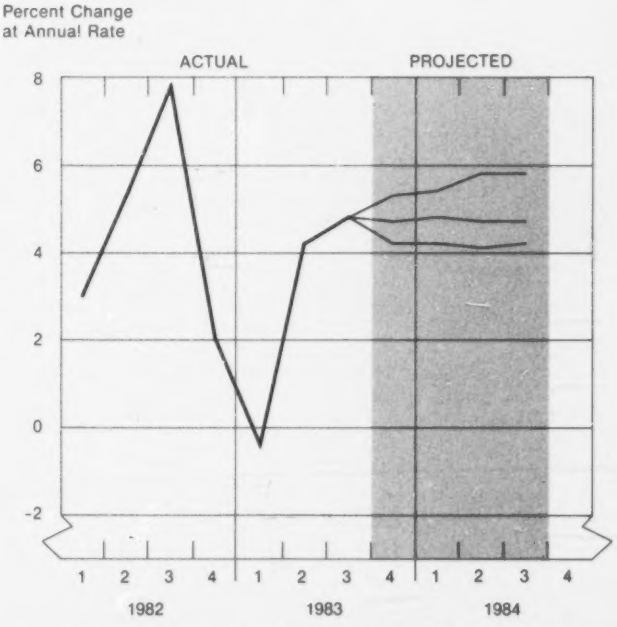
If none of those things are done, the probable outcome will be a recovery that aborts because of escalating interest rates that cripple the housing and car markets and weaken private business investment demand. Even if escalating interest rates do not do enough damage to abort the recovery, they will certainly cause it to be lopsided – substantial growth in private consumption of nondurables and services and in military spending, weak growth in consumer and business investment spending. In an economy plagued by persistent sluggishness in productivity growth, either a recovery aborted by escalating interest rates or one dominated by consumption and defense spending will not meet the widely shared long-term economic objective of increasing the rate of capital formation and thus future economic growth rates.

90-DAY TREASURY BILL RATE



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

CONSUMER PRICE INDEX



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Consumer Optimism Maintained at Record Level

Richard T. Curtin
Director, Surveys of Consumer Attitudes
Survey Research Center
The University of Michigan

Widespread Optimism

In the third quarter 1983 survey, the Index of Consumer Sentiment was 91.6, just above the 91.5 recorded one quarter earlier, and the highest quarterly reading since the peak of 94.4 was recorded in 1972. In total, the Index has gained 37.2 Index points since the all-time cyclical low was recorded in 1980:2, a larger increase than was posted following either the 1973-75 recession (31.5 Index-point improvement) or the 1969-70 recession (20.0 Index-point improvement). Although the overall level of consumer sentiment has remained unchanged during the past six months, small improvements in evaluations of current economic conditions were offset by small declines in expectations.

The recovery in consumer sentiment has been wide-ranging, covering attitudes toward personal, business, and market conditions; and the sentiment recovery has been broadly based, occurring across all regions of the country and across all age and income subgroups. Among families with incomes of $20,000 and over, the Index of Consumer Sentiment rose to 101.5 in the third quarter survey, up from 99.3 in the second quarter 1983 survey, and nearly 30 Index points above the year-earlier reading. Residents of each major geographic region, and each age subgroup, posted increases of at least 20 Index points above the year-earlier readings.

Rapid Pace of Recovery Expected to Moderate

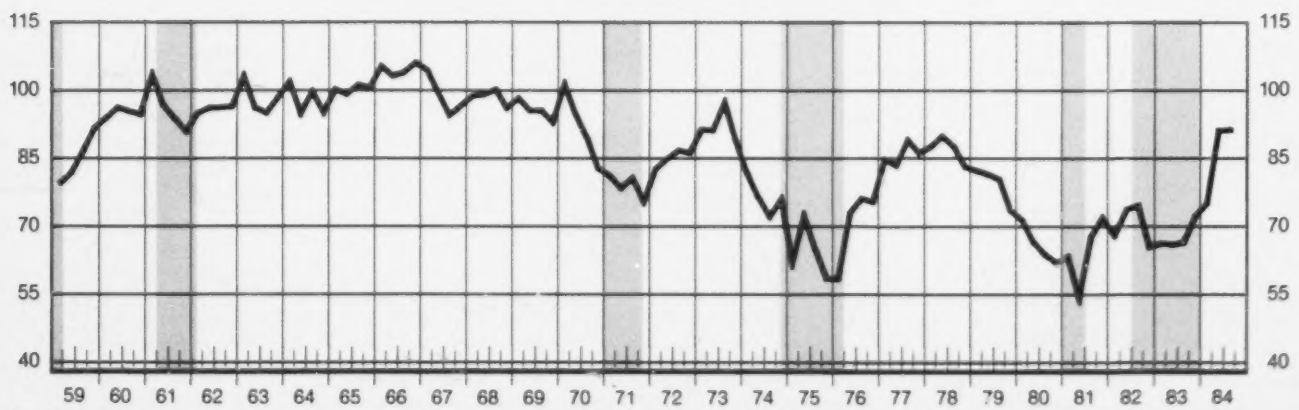
The majority of consumers since mid-1983 have reported both an ongoing recovery in the economy and the expectation that the economic expansion would continue through the year ahead. The pace of improvement in evaluations of both current and expected economic conditions has slowed, however, as evaluations reached record levels.

By the start of 1983, consumers had experienced more than five years of growing economic adversity: rising and then double-digit inflation, followed by record high interest rates and double-digit unemployment rates. After this prolonged period of economic adversity, consumers became increasingly habituated to news of unfavorable economic developments. Consumer reaction to news of each additional unfavorable development declines with habituation, unless the development represents a significant and unexpected further deterioration in the economy. Just as attention to news of unfavorable developments falls with habituation, attention to news of favorable developments is thereby increased. When the economy began to recover in 1983, habituation helped minimize the importance of ongoing unfavorable economic trends and helped magnify the importance of news of favorable developments. In addition, the favorable developments reported by consumers in 1983 were widely expected, as measured by earlier surveys; and this also acted to focus perceptions on favorable developments. As a result, by mid-1983 the consumer surveys established a new all-time record level of favorable perceptions of recent changes in the economy.

Reports that overall business conditions had improved during the past year were given by 63 percent of all families in the third quarter 1983 survey, a higher proportion than recorded following any of the prior six recessions during the past 30 years. Initially the pace of improvement was rapid: the proportion of families reporting improved business conditions was just 14 percent at the close of 1982, but the proportion about doubled in each of the first two quarters of 1983 (from 14 to 27 to 59 percent). Only a small additional increase was recorded in the 1983:3 survey in favorable evaluations of current business conditions (to 63 percent). News of favorable economic developments was heard and recalled somewhat less freqently in the third quarter survey (69 percent) than at mid-year (80 percent), but substantial-

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

ly more than the 29 percent recorded one year earlier. Reports of lower interest rates and easier credit conditions fell to 9 percent in the third quarter survey, from 16 percent one quarter earlier. The sharp increase in favorable reports of economic developments during early 1983 involved increases in employment. References to increased employment rose from 6 percent in the third quarter of 1982 to 29 percent in the second quarter of 1983, but fell slightly to 27 percent in the third quarter survey. Twice as many families expected unemployment to decline as to increase during the year ahead in the 1983:3 survey (39 versus 16 percent), largely unchanged from one quarter earlier but nearly the reverse of the negative balance recorded one year earlier (17 versus 46 percent).

Consumers remained very optimistic about the future course of the economy, but their responses indicated that a slower rate of improvement was also expected. Among all families, 47 percent expected business conditions to improve during the year ahead, below the all-time record level of 52 percent recorded in the second quarter but well above the 34 percent recorded one year earlier. Just 9 percent of all families expected a worsening economy, up from 7 percent one quarter earlier but below the 22 percent recorded one year earlier.

The improvement in unemployment expectations during early 1983, and their subsequent maintenance at favorable levels, has been the primary factor behind the recent improvement in both short- and long-term prospects for the economy as a whole. Among all families, 60 percent expected good times financially in the economy as a whole during the next 12 months, just below the 61 percent recorded in the second quarter survey but substantially above the 27 percent recorded one year earlier. Longer-term business expectations have also improved during the past year, but to a lesser extent. Among all families, 38 percent expected good times financially during the next five years in the economy as a whole, just below the 39 percent recorded in the second quarter but above the 24 percent recorded one year earlier. Confidence in government economic policies to reduce unemployment and inflation significantly improved by the fall of 1983, nearly reversing the entire deterioration in confidence recorded during the past two years. Among all families, 27 percent rated government economic policies favorably in the third quarter 1983 survey, up from 18 percent one year earlier and just below the 30 percent recorded two years earlier—the highest level recorded since President Reagan entered office. Unfavorable evaluations were less frequent, held by 22 percent of all families in the 1983:3 survey, down from 33 percent one year earlier and just above the 21 percent recorded two years earlier.

Higher Interest Rates Expected

The expected moderation in the pace of recovery also reflects rising concern with interest rates. Increases in interest rates were expected during the year ahead by 44 percent of all households in the third quarter 1983 survey, about twice the 20 to 23 percent recorded in each of the prior four quarterly surveys. Declines in interest rates were expected by only 19 percent of all households in the survey, down from 31 percent one quarter earlier and 40 percent one year earlier. This growing concern has left interest rate expectations less favorable than at any other time during the preceding two years.

Rising Interest Rates Halt Further Improvement in Buying Attitudes

Rising mortgage interest rates have caused attitudes toward market conditions for houses to recede slightly from the record favorable levels recorded in the second quarter 1983 survey. Among all families in the third quarter survey, 58 percent thought that buying conditions for houses were favorable, down from the peak of 64 percent one quarter earlier. The proportion of respondents that mentioned the availability of lower mortgage rates fell to 47 percent in the third quarter from the peak of 57 percent in the second quarter, while complaints about high mortgage rates rose to 28 percent in the third quarter survey, up from 23 percent in the second quarter, marking the first quarterly rise in references to high mortgage rates in more than a year. Despite the small increases in mortgage rates, overall attitudes toward market conditions for houses have remained at favorable levels. On balance, more families continued to cite lower rather than higher mortgage rates in the third quarter survey, even if by a narrower margin. In addition, families continued to mention the availability of lower housing prices more frequently than high housing prices (19 versus 16 percent).

Attitudes toward market conditions for cars have also remained largely unchanged at very favorable levels, and, as for house buying attitudes, further upward momentum has been halted by concerns with rising interest rates. Among all families, 64 percent thought that buying conditions for automobiles were favorable in the third quarter 1983 survey, just below the peak of 65 percent recorded in the second quarter but substantially above the 37 percent recorded one year earlier. The proportion of families that mentioned the availability of lower interest rates on vehicle loans was 33 percent in the 1983:3 survey, down from 40 percent one quarter earlier but well above the 7 percent recorded one year earlier. In addition, the 1983:3 survey recorded the lowest number of consumers complaining about high car prices in more than five years: 18 percent, down from 30 percent one year earlier. In contrast, the appeal of price discounts and rebates was mentioned by 26 percent of all families in the third quarter, unchanged from one quarter and one year earlier.

Improved Personal Finances Support Spending Plans

In the third quarter 1983 survey, consumers reported an increased readiness to draw on savings and to incur new debt in order to finance major new purchases (see Table 1). Among all families, 27 percent reported that they were not reluctant to incur new debt, more than twice the 12 percent recorded one year earlier, and the highest level recorded during the past three years. The use of accumulated savings to make major new purchases was viewed with favor by 36 percent of all families, up from 25 percent one year earlier and 30 percent three years earlier.

The financial situation of American families improved substantially during the past year. In the second and third quarter 1983 surveys, more families reported that their financial situation had improved rather than worsened during the past year, in sharp contrast to the prior three years when unfavorable evaluations predominated. The recent improvement in personal finances was particularly evident among

TABLE 1. Opinions about Whether Now Is a Good Time to Use Credit or Savings for Major Purchases

Opinion	1980:3	1981:3	1982:3	1983:3
OK to Use Credit	15%	13%	12%	27%
Pro/Con	1	1	1	1
Not OK to Use Credit	83	83	85	71
Don't Know; Not Ascertained	1	3	2	1
OK to Use Savings	30	29	25	36
Pro/Con	1	1	1	0
Not OK to Use Savings	60	68	72	62
Don't Know; Not Ascertained	9	2	2	2

The questions were "If there were something big that you wanted to buy, do you think that now is a time when it would be OK for you to buy it on credit, or is now a time when you would be *especially reluctant* to take on new debt?" and "If there were a major purchase that you wanted to make, do you think that now is a time when it would be OK to use some of your savings, or is now a time when you would be *especially reluctant* to use some of your savings?"

families with incomes of $20,000 or more. By the third quarter of 1983, twice as many high-income families reported that their financial situation had improved rather than worsened (48 versus 23 percent), while just one year earlier the proportions were almost equal (36 versus 35 percent). A major reason for this recent improvement involved more frequent reports of income increases. Among high-income families, 43 percent reported that their family income had increased during the past year, up from 33 percent one year earlier.

While the improvement in the financial situation of households since 1982 has been substantial, the 1982 level itself already incorporated improvements from the record 1980 lowpoint. The underlying reason for this longer-term improvement in evaluations of personal finances has been the declining rate of inflation. In the third quarter 1983 survey, just 16 percent of all families mentioned the adverse impact of inflation on family finances, down from 28 percent one year earlier. The frequency of references to rising prices has declined steadily since 44 percent was recorded at the start of 1981.

Consumers remained optimistic about future changes in their personal financial situation. Among all families, 36 percent expected improvement in their financial situation during the year ahead in the 1983:3 survey, down somewhat from the peak of 40 percent in the second quarter and above the 31 percent recorded one year earlier. Just 11 percent of all families expected a worsening financial situation in the third quarter survey, up from 8 percent in the second quarter but below the 18 percent recorded one year earlier.

Compared with third quarter 1982, income expectations were largely unchanged in the third quarter 1983 survey, although somewhat more concentrated in the 1-5% increase range. Among all families, approximately the same proportion expected their income to remain unchanged (27 percent) or to decline (13 percent) in the third quarter survey as one year earlier. The proportion of families that expected income increases of 6% or more was 31 percent in the 1983:3 survey, down from 35 percent one year earlier, while the proportion of families that expected increases of 1-5% was 22 percent in the 1983:3 survey, up from 16 percent one year earlier.

On average, consumers expected an annual rate of inflation of 4.9% in the third quarter 1983 survey, up from 4.6% one quarter earlier but below the 5.9% recorded one year earlier. The steep three-year decline in price expectations, coupled with the relative maintenance of nominal income expectations, has resulted in greatly improved real income expectations. When the expected rate of inflation reached the all time peak of 11.9% in the first quarter of 1980, only 20 percent of all families expected their income to increase by a larger amount. By the third quarter of 1983, when the expected inflation rate was 4.9%, a full 42 percent expected higher family income increases.

Summary Outlook

Consumer sentiment was more favorable in the third quarter 1983 survey than at any other time during the prior decade. Widespread optimism about prospects for personal finances as well as for the economy as a whole was recorded. The record levels of optimism are based on the current or the expected direction of change in the economy, following a prolonged period of adversity, not on the current or expected level of economic performance. Nonetheless, the very favorable attitudes and expectations point toward a robust recovery in sales of vehicles, houses, and large household durables through mid-1984. The pace of the recovery will not depend on further gains in the *willingness* of consumers to make large discretionary purchases, but rather on the *ability* of consumers to finance significant and cumulative increases in their purchases of vehicles and houses without a resurgence in interest rates.

November 1983

Results from the August NABE Survey

Richard E. Barfield
Survey Research Center
The University of Michigan

The sixth in the series of quarterly surveys of National Association of Business Economists (NABE) members was conducted in August, asking for forecasts of various economic series and opinions about current economic policy matters.

Economic Forecasts

Table 1 displays median values of forecasts for selected economic series asked about in August. Real GNP was expected to increase by 5.4 percent from 1983:2 to 1983:4 (up from 4.6 percent given in the May survey for the second half of the year) and by 4.6 percent from 1983:4 to 1984:4. Consumer prices were expected to increase by 4.2 percent during the second half of 1983 (down from the 4.9 percent predicted in May) and by 5.1 percent for the year ending in 1984:4. Real fixed investment was forecast to increase modestly in the 1983:2-1983:4 period (at the same 2.7 percent rate given in May) and somewhat more vigorously in the next year. Not displayed in the table is the latest forecast of the longer-run inflation rate, which was projected to be about 6 percent over the next decade, a value which has changed little during the six surveys conducted to date. Uncertainty about the longer-run trend—as measured by the spread between the lowest and highest plausible values expected for the CPI over the next decade—may have declined, but by only a small amount at best.

TABLE 1. Forecasts of Selected Economic Series, August 1983

Series	Median Value
Annualized Percent Change:	
Real GNP	
1983:2-1983:4	5.4
1983:4-1984:4	4.6
Consumer Price Index	
1983:2-1983:4	4.2
1983:4-1984:4	5.1
Real Fixed Investment	
1983:2-1983:4	2.7
1983:4-1984:4	4.9
Percent:	
Unemployment Rate	
1983:4	9.2
1984:4	8.5
Prime Rate	
12/31/83	11.2
6/30/84	10.9
Millions of Units:	
New Private Housing Starts	
1983:4	1.6
1984:4	1.7
Automobile Sales	
1983:4	9.4
1984:4	10.0

The business economists predicted that the unemployment rate would fall to 9.2 percent by the fourth quarter (down substantially from the 9.9 percent rate forecast in May) and would decline further to 8½ percent by 1984:4. The prime rate was foreseen to rise slightly by the end of the year, to 11.2 percent (up about a percentage point from the May figure), and to decline only slightly from that level by the middle of next year. New private housing starts were expected to average about 1.6 million units in the fourth quarter (about the same as in the May forecast) and to rise by a further 100,000 units by 1984:4. Car sales were projected to reach 9.4 million units in 1983:4 (up from the 9.2 million May forecast) and to rise further to 10 million units by the fourth quarter of next year.

As mentioned in our last report, NABE respondents are classified according to their primary affiliation in six groups: manufacturing, nonbank finance, trade associations and others not elsewhere classifiable, government and academic, commercial banking, and consulting. The major difference noted among these groups' forecasts was the tendency for government and academic NABE members to anticipate a somewhat less vigorous recovery. That is, they expected lower growth in real GNP, fixed investment, housing starts, and auto sales, while projecting a higher prime rate through mid-1984. They also saw somewhat lower inflation rates both in the short and the long run.

Fiscal and Monetary Policy

As in the previous surveys, the business economists were asked several questions about recent fiscal and monetary policy. Trends over the past four surveys in their assessment of the appropriateness of fiscal and monetary policy are displayed in Table 2. During the three surveys in 1983, there has been an identifiable shift toward viewing fiscal policy as "too stimulative," though so far this represents only a partial return to the proportion holding that view last November. Among the affiliation groups, the only relative outliers were those in manufacturing, where only about 65 percent saw current fiscal policy as too stimulative, and those in commercial banking, where fully 30 percent more held that view. In a matter related to fiscal policy, respondents were asked whether, in view of the stronger-than-anticipated recovery reported in the second quarter, they had revised their estimates of federal budget deficits for the next two fiscal years. Sixty percent reported a downward revision in their estimates and 34 percent reported no change, with the small remaining proportion claiming to have increased their deficit projections.

Concerning recent monetary policy, there has been little change in the proportions seeing it as "too stimulative," "about right," and "too restrictive" during 1983 (Table 2), with about a quarter, two-thirds, and a twelfth respectively holding those views. Again those economists in commercial

TABLE 2. Trends in Opinions about Fiscal and Monetary Policy, November 1982-August 1983

Opinion	November	February	May	August
Fiscal Policy:				
Too Stimulative	79	70	73	76
About Right	8	23	21	20
Too Restrictive	13	8	7	4
Monetary Policy:				
Too Stimulative	18	27	26	23
About Right	75	68	67	69
Too Restrictive	7	5	7	8

The questions were "What is your view about current fiscal policy – is it too stimulative, too restrictive, or about right?" and "What is your view about recent monetary policy actions – have they been too stimulative, too restrictive, or about right?"

banking and manufacturing were outliers, with the former most likely to see fiscal policy as too stimulative and the latter most likely to see it as about right. In another question relating to monetary policy, NABE members were asked to select a primary reason for the rise in interest rates during the several months prior to the August interview. About a third chose "the effects of large budget deficits," 28 percent chose " a more restrictive monetary policy," 23 percent selected "the lagged effects of earlier stimulative monetary policy," and the remainder opted for some other main reason.

Other Issues

Because there has been some discussion about the duration of the recovery from the 1981-82 recession, respondents were asked if they thought "the duration of the current recovery is likely to be cut short?". About 40 percent answered yes, and they in turn were asked to select from a list the main reason for the shorter recovery. Forty-two percent chose "large projected budget deficits" and 38 percent "high interest rates" as the reason, with the rest scattered among other possibilities.

Respondents were asked several questions about the international economy. When asked whether "in view of recent developments" they viewed international debt problems as more or less serious than before, 28 percent said more serious and 17 percent less serious, with the remainder taking the "about the same" position. The economists were asked whether they approved of the administration actions to provide "temporary" trade relief to certain industries. Only 17 percent approved, though a somewhat larger proportion (29 percent) of those in manufacturing did so. Expanding on this point, the question was posed as to whether, in view of the actions to restrict imports, the threat of international protectionism is increasing. Slightly over two-thirds of the NABE members said yes. The final question in this area asked for the change expected in the international value of the dollar, "calculated on a trade-weighted basis," between August and the end of the year. One-third expected an increase (40 percent of the government/academic economists), 46 percent expected a decrease, and about one-fifth believed there would be no change.

Two questions concerned agricultural policy. The first asked for an assessment of the Payment-in-Kind (PIK) program to support farm income; about two-fifths favored the program and three-fifths opposed it. The second question asked whether an Agricultural Department proposal to expand the PIK program to reduce next year's wheat production was a good or a bad idea. Only 19 percent of the business economists (and only 11 percent of those in government and academe) said "good idea."

The final question in the August survey concerned relations between the Federal Reserve and the executive branch of the federal government. It was noted that conflicts between the Fed and the president are reported during most administrations, and the business economists were asked what course of action an administration should take when the situation did arise: should it express its views on monetary policy in public, express them privately to Fed officials but not publicly, or say nothing at all? Table 3 displays the economists' responses to this question, distributed by their primary affiliation. Over half opted for the public response, with about 40 percent believing that a private discussion of the disagreement was more appropriate.

TABLE 3. How an Administration Should Respond to Disagreement with Federal Reserve about Monetary Policy by Primary Affiliation of Business Economists (Percentage Distribution)

	Primary Affiliation Group						
Response Category	Manufacturing	Nonbank Finance	Trade Associations & "Other"	Government & Academic	Commercial Banking	Consulting	All Groups
Express Views Publicly	57	46	54	52	53	64	55
Express Views Privately to Fed But Not Publicly	38	50	35	45	40	33	39
Express Views Neither Publicly Nor Privately	4	4	9	0	5	3	4
Other Response	1	0	2	3	2	0	2

The question was "...about relations between the Federal Reserve and the executive branch of the federal government. At some time during almost every president's term, some policy disagreement between the president and the Federal Reserve has been reported which raises questions about the independence of the central bank. When that situation arises, which of the following courses of action do you think the administration should take: should it (1) express its views on monetary policy in public, (2) express its policy views privately to Fed officials but say nothing in public, or (3) say nothing either in public or in private about the disagreement?"

Some Lessons from Research in Macroeconomic Forecasting

Victor Zarnowitz
Professor of Economics and Finance
The University of Chicago

On Recent Growth, Uses, and Assessments of Macroforecasts

Aggregate economic forecasts are now regularly prepared by large numbers of individuals and organizations for both public dissemination and private uses. Only three decades ago published macropredictions were issued by relatively few government and academic sources, mainly for annual GNP in current dollars and its major expenditure components. Today business and financial press and other media provide large amounts of current information on forecasts by government officials, private experts, surveys of economists, businessmen, consumers, etc., for a whole range of macroeconomic variables in real as well as nominal terms. At considerably higher costs, thousands of more detailed predictions on various aspects of the economy are available from the major econometric service bureaus and other consulting services. The forecasts are often updated monthly, even though they refer to quarterly time series, and they cover sequences of several quarters ahead as well as annual values. The coverage includes totals and at least the main components of output, income, the labor market and financial market variables, price indexes, and other factors such as selected cyclical indicators.

On the supply side, the enormous increase in the volume and complexity of the macroforecasts can readily be related to the growth of modern economics and statistics in general, and the rapid development of electronic computer and econometric modeling technologies in particular. On the demand side, the availability of essentially new "economic intelligence" products at relatively falling costs was clearly a major factor, too. The market for this information and the associated processing techniques kept expanding as more and more businesses discovered the uses of macroforecasts as inputs into microforecasts of sales, input requirements, and capital budgets. A whole new profession of business economists-forecasters emerged and expanded at a swift pace. Government developed a strong demand for macroeconomic forecasts and policy simulations.

The scientific evaluation of the forecasts has lagged behind their production and current uses and interpretations but nevertheless has made considerable progress in the short period of the development of the subject. Both users and makers of forecasts can benefit from these advances. Here I shall concentrate on some results of my own work in progress at the National Bureau of Economic Research (NBER).

Briefly, two lessons will be drawn from this work, as follows:

1. There are gains from selecting and combining forecasts from different sources.
2. There are complementary methods which it is advantageous to combine in the production or adaptation of forecasts.

The Relative Accuracy of Individual and Group Forecasts

The group mean forecasts from a series of surveys are on the average over time more accurate than most of the corresponding sets of individual predictions. This is a strong conclusion, which applies to all variables and predictive horizons covered in my study of a large collection of forecasts made by participants in the quarterly ASA-NBER surveys. Time series of summary results from this survey are regularly charted and tabulated, and often discussed, in ECONOMIC OUTLOOK USA, hence these results may be of particular interest to our readers who use this information.

Table 1 sums up the evidence for a large number of the more regular participants in the surveys (see notes for detail). Six variables are covered, and in each case the forecasts refer to the current and the four following quarters Q0-Q4 (at the time of the survey, forecasters have only preliminary data for the preceding quarter). The individual-to-group ratios of root mean square (RMS) errors M_i/M_{gi} are predominantly and on the average larger than 1.0 (lines 1 and 2). The percentages of those who outperformed the corresponding group averages over time are not large. When the results are aggregated across the predictive horizons for each variable, these minorities range from 20% for GNP to 33% for the change in business inventories (line 2). When disaggregated by the distance to the target quarter into 30 categories (6 variables $\times$ 5 horizons), the proportions of cases where $M_i/M_{gi} < 1$ range from 8% to 42%, averaging 26%. The advantage of the group means is the greatest for the nearest targets, tending to decline as the predictions reach out further into the future. This suggests that the longer forecasts contain less independent information per individual survey member (person or firm) so that the gains from averaging them are smaller.

Rank correlations among the respondents according to the same relative error measures are positive for all variables and target quarters (lines 3 and 4) and they are statistically significant in most cases by conventional tests. Thus the performance of a sufficient number of survey members shows a moderate degree of consistency: those who succeeded in one category also tended to succeed in others. No single individual can be expected to be superior to all others at all times and for all variables and horizons. But a small number of the survey participants did perform better in most categories than the composite forecasts, which is not a minor accomplishment. The predictive power of a series of group averages is enhanced by the combination of at least partly independent judgments and methods (see below). It is also helped by offsets between random errors of under- and overprediction.

It follows that a group average forecast has a built-in advantage vis-á-vis individual forecasts: a strategy of random selection among the latter will involve a greater risk of error than that of using the average. As illustrated in lines 5-6 (for Q0) and 7-8 (for Q3), the RMS errors of the overall group mean forecasts are always smaller than the averages

TABLE 1. Comparing Individual with Group Mean Forecasts for Six Aggregate Variables, Selected Summary Statistics, 1968-1979

Line	Item	Variables Predicted[a] GNP (1)	IPD (2)	RGNP (3)	UR (4)	CEDG (5)	CBI (6)
	Ratios of Root Mean Square Errors (RMSE): M_i/M_{gi}[b]						
1	Means	1.17	1.15	1.14	1.18	1.10	1.10
2	$M_i/M_{gi} < 1$,% of Cases	20	26	22	29	24	33
	Rank Correlations Among Individuals According to the M_i/M_{gi} Ratios[c]						
3	With Other Variables	.42	.39	.45	.32	.29	.31
4	Across Target Quarters	.33	.53	.33	.60	.22	.66
	RMSE of Forecasts for the Survey Quarter (Q0)[d]						
5	Individual Forecasts, Mean	.77	.55	.85	.22	3.37	8.21
6	Group Mean Forecast	.66	.42	.70	.16	2.87	8.07
	RMSE of Forecasts for Same Quarter Year Ahead (Q3)[d]						
7	Individual Forecasts, Mean	1.10	.88	1.39	.94	4.44	10.99
8	Group Mean Forecast	.98	.77	1.23	.88	4.09	10.08

NOTE: This table covers 79 individuals (persons or firms) who participated in at least 12 of the 42 quarterly ASA-NBER business outlook surveys in the period from 1968:4 through 1979:1. Errors for GNP, RGNP and CEDG are measured as differences, percent change predicted minus percent change actual, for each successive (nonoverlapping) target quarter, Q0-Q4, where Q0 denotes the current (survey) quarter, Q1 the next quarter, Q2 the second future quarter, etc. Errors for UR and CBI are measured as differences, predicted level minus actual level, for the corresponding quarters.

[a]GNP = Gross national product in current dollars; IPD = implicit price deflator; RGNP = GNP in constant dollars; UR = unemployment rate; CEDG = consumer expenditures on durable goods; CBI = change in business inventories.

[b]M_i = root mean square error of the i^{th} individual's forecasts; M_{gi} = RMSE for the corresponding series of group averages of predictions by all those forecasters who responded to the same surveys as the i^{th} individual. Line 1 shows the means across the five target quarters, Q0-Q4, of the ratios M_i/M_{gi} for each of the six variables covered. Line 2 shows the percentage of cases where individuals had smaller RMSE than the corresponding group means ($M_i/M_{gi} < 1$).

[c]Spearman's rank correlation coefficients ρ based on the M_i/M_{gi} ratios for all individuals covered. Averages across the five target quarters Q0-Q4. Line 3 refers to the correlations across variables for each target quarter. Line 4 refers to the correlations across target quarters for each variable.

[d]Lines 5 and 7 show the means of the individual RMSE (M_i) for the Q0 and Q3 forecasts, respectively. Lines 6 and 8 show the corresponding RMSE measures for the series of the overall group mean forecasts by the 79 individuals covered.

of the RMS errors of the individual forecasts. The same applies to the results for Q1, Q2, and Q4 (not shown). Note that the advantage of the group forecasts persists but diminishes in relative terms as we move from the shortest to the longest predictions, while the listed RMSE measures systematically increase (compare the corresponding entries in lines 5 and 7 and in lines 6 and 8).

There are many ways in which forecast makers and users interact and influence each other directly and indirectly: informal exchanges, opinion polls, predictions publicized in the media and sold as expert advice. Aggregative data and certain established techniques and models are all in the public domain. Differences among the individual forecasts may be further reduced by the reluctance of risk-averters to deviate much from what they believe the prevalent "consensus" to be. Yet responsible forecasters do not merely imitate each other but use their own judgment so that their predictions contain some independent information. Indeed, if simple or weighted averages of individual forecasts result in significant gains in accuracy, as is often the case, it is because these forecasts are sufficiently diversified.

Forecasting Methods and Results

The ASA-NBER surveys ask members to rank the items in a short list of general forecasting techniques according to their own working preferences. On the average, nearly 60 percent report using primarily the "informal GNP model" (INF), in which the major expenditure components of the gross national product are predicted in various ways and combined into an overall forecast, as a rule after a series of checks and adjustments for plausibility and consistency (Table 2, column 1). This is a flexible and eclectic approach, relying mainly on judgment, data analysis, and relatively simple calculations. About a quarter of the observations come from questionnaires ranking as first the econometric models, either owned ("inside," INS) or subscribed to ("outside," OUT). Fewer than half of these rely principally on OUT, models of econometric service bureaus, but many primarily judgmental (INF) forecasters list OUT in the second place. Leading indicators (LDI) and anticipation surveys (ANT) are used by large majorities of the survey participants but ranked predominantly second and third. Other methods (CTH) are seldom specified.

The different approaches tend to complement each other: e.g., new readings on monthly cyclical indicators or the latest results from an investment or consumer anticipations survey may be used to modify forecasts from econometric models or the informal approach. Understandably, then, the predominant forecasting practice is to use various combinations of these methods or techniques in a more or less judgmental fashion. The reported rankings differ widely, reflecting the backgrounds, interests, and preferences of the individuals; but no single approach is widely treated as if it were self-sufficient and always superior to each of the others.

In fact, the differences between the average RMS errors listed in Table 2 for the groups classified according to the reported methods are for the most part small and of uncertain significance. However, when first ranks only are considered (lines 1-6), OUT tends to have the smallest errors, with INF a close second; the other categories earn mixed records that are about equal on the average across the variables. When only their uses in lower ranks are considered (lines 7-12), the relative positions of the methods are quite different: LDI and ANT play the largest roles here, and the accuracy statistics for the corresponding groups are favorable.

What all this suggests is that combining the different approaches helps, particularly when done by experienced forecasters. Thus subscribers (OUT) in our sample perform most of the time and on the average better than the model proprietors (INS), probably because OUT is dominated by large corporations using well-known econometric service bureaus and their own professional staffs, whereas INS includes not only some of the leading models maintained by teams of experts but also a few models used exclusively by the reporting individuals.

The ex ante forecasts of econometric type commonly involve judgmental predictions of exogenous inputs, recurrent revisions of the model, and frequent adjustments of the constant terms ("fine tuning"). With judgmental adjustments, such forecasts are, on the average across the different variables, horizons, and periods, about as accurate as the average predictions from representative surveys of business economists—not surprisingly because much of the relevant information and knowledge is shared by the forecasting profession. Without the adustments, the econometric forecasts are on the whole considerably worse, which argues against mechanical uses of existing models wherever predictive accuracy is important.

TABLE 2. Average Accuracy of Forecasts by Methods Ranked First and Lower, Six Variables, 1968-80

			GNP		IPD		RGNP		UR		CEDG		CBI	
Line	Method[a]	% of Obs.[b] (1)	$\overline{RMSE}$ (2)	Rk (3)	$\overline{RMSE}$ (4)	Rk (5)	$\overline{RMSE}$ (6)	Rk (7)	$\overline{RMSE}$ (8)	Rk (9)	$\overline{RMSE}$ (10)	Rk (11)	$\overline{RMSE}$ (12)	Rk (13)
	According to First-Ranked Method[c]													
1	INS	16	1.09	5	.76	3	1.25	5	.66	5	4.11	4	11.22	5
2	OUT	10	.89	1	.72	2	1.05	1	.52	1	3.62	1	9.69	2
3	INF	59	.96	2	.71	1	1.14	2	.58	2	4.02	2	9.62	1
4	LDI	6	1.00	4	.79	4	1.24	4	.62	4	4.45	5	10.53	6
5	ANT	2	.99	3	.85	6	1.22	3	.71	6	4.51	6	9.70	3
6	OTH	7	1.15	6	.83	5	1.27	6	.59	3	4.06	3	10.06	4
	According to Lower-Ranked Method[d]													
7	INS	4	.76	1	.72	3	1.12	2	.57	2	3.93	2	8.76	1
8	OUT	22	.98	5	.71	1	1.13	4	.59	5	3.93	3	10.21	6
9	INF	10	1.03	6	.76	5	1.19	6	.62	6	3.99	5	10.04	5
10	LDI	31	.97	3	.72	4	1.12	3	.58	3½	3.94	4	9.47	4
11	ANT	30	.95	2	.71	2	1.10	1	.54	1	3.87	1	9.33	3
12	OTH	3	.97	4	.87	6	1.18	5	.58	3½	4.39	6	9.20	2

NOTE: This table covers 79 individuals who participated in at least 12 of the 46 quarterly ASA-NBER business outlook surveys in the period from 1968:4 through 1980:1. See notes to Table 1 on the symbols for the six variables covered and measurement of the errors. $\overline{RMSE}$ denotes the average of root mean square errors of forecasts for Q0-Q3 (the current survey quarter and the three quarters ahead). Rk denotes the rank according to the $\overline{RMSE}$, from the smallest to the largest (using more digits than shown in the table).

[a]INS = inside (own) econometric model; OUT = outside econometric model (services subscribed to); INF = informal GNP model; LDI = leading indicators; ANT = anticipations surveys; OTH = other methods (write in).

[b]The percentages refer to a total of 39,097 observations for lines 1-6 and 77,522 observations for lines 7-12

[c]Measures refer to the responses of those forecasters who reported using as their primary method INS (line 1), OUT (line 2), etc. Ties for the first rank are not included.

[d]Measures refer to the responses of those forecasters who reported using the given method (INS, OUT, ..., etc.) but ranking it second through sixth (not first).

Concluding Observations

The above findings are consistent with other evidence reported in forecast appraisals. They support the following general inferences and recommendations:

1. Decision and policy makers interested in increasing the average accuracy of the predictions they use will do well to consult regularly the results of professional surveys of the economic outlook as well as their own favorite forecasts. This is so because combining predictions from different, sufficiently independent sources yields series of forecasts that are more accurate over time than most of their individual component sets.
2. For well-designed surveys with many participants, simple averaging (means or medians) may be the best strategy. For small numbers of forecasters selected for the high quality of their past performance, weighted combinations may prove to produce further gains.
3. Business economists and others who regularly forecast the course of the economy tend to be result-oriented and eclectic, not committed to any single approach but inclined to use any combinations of models, judgments, and techniques that they deem suited to the particular task on hand. Models are in general used with judgmental adjustments rather than mechanically. Judgment is applied to the latest news, and it reflects experience and broadly defined information, including the recent evolution of business, financial, and consumer expectations and experts' predictions. These practices make on the whole good sense, given the complementarity of the general approaches to macroeconomic forecasting and the evidence on the comparative accuracy of forecasts classified by the reported methods.
4. Although composite forecasts are better than most of the corresponding individual forecasts, some survey members are shown to have outperformed the "consensus" in most respects. It is the individuals or teams using the better models, techniques, and judgments who are likely to score significantly above the difficult-to-beat group means. Their forecasts deserve attention for the positive value of their independent elements, which are lacking in the predictions of the "follow-the-leader" type. Contrary to some interpretations, the evidence on the relative accuracy of average forecasters from select surveys does *not* indicate any particular merit in adjusting one's predictions so as to "go along with the crowd."

The Effects of Cultural Assimilation and Education on Mexican American Workers' Earnings

Carlos H. Arce* and David L. Torres
National Chicano Council on Higher Education
Austin, Texas

Much literature, both popular and scholarly, exists on the factors which explain the economic condition of Mexican Americans in the U.S. Still prevalent in some of the policy-oriented literature is the notion that Mexican American culture is one of the barriers Chicanos face in relation to their social mobility. In building a conceptual groundwork for the nation's war on poverty, the Council of Economic Advisers relied heavily on the notion of the effect of "culture on poverty" and its implicit deficits (Brown, 1972). In many policy-oriented documents, "socio-cultural barriers" are cited as significant determinants of Mexican Americans' poor socioeconomic condition and as explanations for the inequality between majority and minority workers (SER, 1980). While developing manpower programs for Illinois in 1980, an advisory council recommended programs which addressed the problem of Hispanics' culture "as a restraint to mobility." Recently a widely cited Chicano writer has argued that Mexican culture, especially the Spanish language, is a deterrent to gaining the "public identity" which he considers necessary for both personal development and mobility (Rodriguez, 1982). In short, many policy makers continue to assert that Chicano culture is somehow detrimental to success in the labor market.

Researchers, in examining the question of inequality in the work force, continue to add to the already abundant literature. Their studies have concentrated on a number of important areas, including those related cultural issues. Patterns of language usage among Chicanos have been studied extensively, especially as they relate to assimilation (e.g., Patella & Kuvlesky, 1973; Lopez, 1976, 1978). Researchers have also looked at language usage *vis-a-vis* status attainment. Although results are somewhat sketchy, the association between the use of English and higher socioeconomic status has been suggested (Skrabanek, 1970; Lopez, 1976, 1978). Causality (that is, the question of whether an English orientation leads to a higher status or vice versa) has not been firmly established. Some studies (Lopez, 1976) have concluded that education, which is strongly tied to increased status attainment, is also linked to increased usage of English. Consequently, what one may be observing is the result of education as reflected through an English language orientation which then leads to a higher socioeconomic status.

Various studies have examined patterns of interaction between Chicanos and other race/ethnic groups. Two general strategies have been utilized to examine this question. The first assumes varying degrees of economic and social isolation between Chicanos and mainstream society. Thus, the ethnic group is seen as operating in a subsystem where the opportunities for status advancement are limited (Gordon, 1964; Wilson & Portes, 1980; Yancey, *et al.*, 1976; Nachimas, 1979). The second strategy also assumes varying degrees of isolation between Chicanos and mainstream society; however, here the emphasis is on transmission of cultural norms and values and the detrimental effects which such cultural orientations may have on status attainment (Banfield, 1974; Henggeler & Tabormina, 1978; Anderson & Evans, 1976).

The existing literature on cultural assimilation and status attainment alludes to two types of indicators which may inform a study of this type—measures which reflect interaction between Chicanos and other groups and measures which reflect distinctive cultural traits, including, but not limited to, the use of Spanish.

In this research note, we examine the association between measures of cultural assimilation and workers' outcomes, namely salaries. We then explore the effects of assimilation and education on salaries in order to find out how these two factors jointly and separately determine salaries. This allows us to address one question prevalent in research on minority workers, especially Mexican Americans: Is cultural background a barrier or disadvantage for participants in the U.S. labor force? Does education explain away the observed effects of cultural background? Are there ways in which the two interact to affect wages of Mexican American workers?

Data and Methods

The analysis reported here uses data from the 1979 Chicano Survey conducted by the Survey Research Center. This study obtained face-to-face interviews from a probability sample of 991 adults of Mexican ancestry in five southwestern states (Arizona, California, Colorado, New Mexico, and Texas) and the Chicago metropolitan area. Given the concentration of Mexican Americans in those areas, the sample is estimated to be representative of 90 percent of the United States' Mexican-origin population. Interviews were conducted in either English or Spanish, at the option of the respondents, using questionnaires that had Spanish and English versions of questions. All interviewers were bilingual and nearly equal number of interviews were conducted in English and Spanish. For the present analysis only those respondents who were working at the time of the interview or who had worked within the previous two years were used.

From the very extensive number of variables available, we selected those which tap the concept of cultural assimilation. From these variables we created the following composite measures:

1) *Language preference,* which reflected respondents' views on English/Spanish usage in the U.S., the language they preferred to use, and the language they felt they should use;

*Dr. Arce was, until recently, director of the National Chicano Research Network at the Survey Research Center

2) *Language usage,* which measured the degree of English/Spanish usage around friends, fellow workers, and in intimate situations;
3) *Cultural preference,* which tapped respondents' preferences, such as listening to Spanish radio, reading Spanish-language magazines, and preferring that the respondents' children maintain the Mexican culture when they grow up; and
4) *Social segregation,* which measured the race/ethnicity of the respondents' friends, neighbors, and coworkers.

These four measures produced composite scores from single-item variables that measured the characteristics listed above. For the language preference and language usage variables, the composite scores ranged from zero to twelve; for the physical segregation and cultural traits variables, the composite scales ranged from zero to nine. In all cases, higher scores reflected higher assimilation.

The measures listed above may be considered components of what one usually considers as "cultural background" or, more accurately, cultural orientation. And, as the correlation results listed in Table 1 serve to show, with the exception of language preference, the variables are substantially correlated. Language preference, being a variable which measures attitudinal tendencies toward language usage, seems not to be strongly associated with the other variables, which measure more behavioral facets of culture. This result is interesting in itself because it alludes to a difference between actual behavior and preference for using Spanish. In more general terms, it *may* allude to the possibility that assimilation is an outcome of critical environments rather than one which is independent of other forces.

We created an overall assimilation variable which is a composite of the language usage, segregation, and cultural traits variables. The range for this overall assimilation variable is zero to thirty, with a higher score indicating higher assimilation.

Findings

The correlation results in Table 1 show a positive correlation of .24 between assimilation and salary. A much higher correlation was found between assimilation and education (r = .55). Finally, the correlation between salary and education is .25. Given the high correlation between assimilation and education, can we attribute some of the association between assimilation and salary to education? If so, to what extent?

The correlation results between education and salary and the three assimilation variables prove interesting. Education is associated with the shedding of cultural traits and physical integration at not surprising levels. However, the biggest effect of education, according to the results in Table 1, is its tendency to discourage the use of Spanish. Education is highly correlated with English in terms of preference. This finding, similar to the previous finding where preferred and actual language usage were not found to be significantly correlated, strongly suggests that the use of English versus Spanish may be dictated by the environment, and not by whether one prefers to use one or the other language. It is interesting, too, that the use of English is highly correlated with education, but not as intensively with salary. Cultural trait indicators are also correlated with education at higher levels than with salary. The situation is reversed for segregation, where less physical segregation is associated with more salary. This is a reasonable finding, given that better-paying jobs are not particularly associated with the presence of more Mexican Americans. Given that education and assimilation are here correlated at significant levels, the problem remains of isolating the effects of education in order to better estimate the effects of assimilation on salaries.

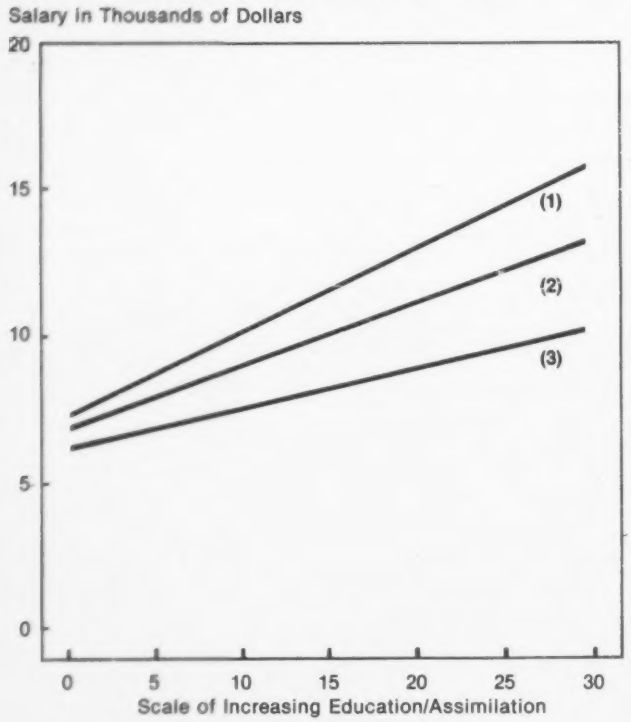
Ordinary least-squares regression equations were calculated to assess the impact of education and assimilation on Chicanos' wages. Chart 1 presents these results. As anticipated, the greatest slope (1) occurs when we examine the effects of education on salaries. The least educated earned only about $7,200 yearly, while those with the most schooling earned about $16,000. A less drastic equation (2) is produced when the effects of assimilation on salaries is calculated. The slope and predicted earnings are less than the predicted equation for education levels. Since we are not controlling for education in equation 2, a substantial proportion of variance here may be attributed to education: as the correlation results showed, education was correlated with language and with other assimilation variables at respectable levels. The lower slope and predicted salaries, however, allude to the possibility that the assimilation variables used here actually serve to "dilute" the predictive value in this equation. The final equation (3) represents estimated salaries based on total assimilation scores *controlling for education.* As one can see, the explanatory power of assimilation is significantly reduced when one controls for education. In fact, the original differential of approximately $6,600 is reduced to slightly over $4,400.

TABLE 1: Correlational Relationship among Assimilation, Education, and Salary of Mexican American Workers (N = 470)

	Cultural "Traits"	Language Preference	Segregation	Language Usage	Total Assimilation	Salary
Language Preference	.0967*					
Segregation	.2462*	.0175				
Language Usage	.3999*	.0474	.5619*			
Total Assimilation	.6854*	.3796*	.4988*	.8786*		
Salary	.1484*	−.0216	.2638*	.2678*	.2399*	
Education	.2453*	.0030	.3660*	.6389*	.5491*	.2468*

*Correlation significant at .05 level.

CHART 1. Effects of Assimilation and Education on Salary: Predicted Regression Results



(1) Education effects: Y = 7.248 + .293X

(2) Assimilation effects: Y = 6.916 + .214X

(3) Assimilation effects, controlling for education effects: Y = 6.230 + .133X

Discussion

Although not shown in Chart 1, most of the explanatory power of the total assimilation variable stems from the segregation component. In a comparison of the explanatory power of the various factors (comparison of R^2s in step-wise regression), the segregation variable, along with the education variable, were the only statistically significant variables in the final equation. For the most part, one can argue that assimilation into non-segregated neighborhoods comes about through better salaries. It would be reasonable to find that the more integrated individuals were netting higher salaries. Consequently, it would be reasonable to argue that causality here runs from salaries to assimilation (in terms of more integrated neighborhoods). Therefore, one is left with a final picture where salaries and education *affect* assimilation, rather than vice versa.

Seemingly the only dimension of cultural assimilation which is of any explanatory importance here is one which is made possible through higher salaries. The results obtained here allow us to entertain the notion that assimilation factors may be a reflection of the Chicano's changing environment as they achieve higher status. Therefore, the presence or absence of cultural attributes may not be all causal. Indeed, changes in cultural attributes may reflect the presence of more important variables like the education variable used here. As our findings also serve to indicate, preference for the use of one or the other language is one thing while the actual usage of a language is another phenomenon which is affected by the environment. Similarly, preference for various aspects of Chicano culture may be present even among those who do not demonstrate such aspects, since their usage may also be affected by the immediate environment. It would be reasonable to assume that, while cultural assimilation factors are useful for examining status attainment among Chicanos, such factors may be a reflection of other, more dynamic and determinant forces, which come to bear as Chicanos participate in mainstream America. Our findings, although modest, suggest that "structural variables" (that is, factors which form emloyees' environments) may be important elements for further investigation. Factors such as economic sectors, industrial settings, class and career lines, are and should continue to be avenues for further investigation. This research strategy should also examine the manner in which individuals find themselves in different environments. No doubt, culture must play some part in determining success; however, the actual dynamics of such a process are not in evidence here, and evidently do not play as great a part as other factors. Indeed, those who have found lower "aspirations" among Chicanos may be looking at lower "expectations"—realistic appraisals of chances for success in the job market. This, too, would suggest that the study of labor market environments, and entrance into these environments, might add greater insight into the nature of inequality than studying individual orientations to specific cultures.

References

Anderson, James & Evans, Frances. Family socialization and educational achievement in two cultures: Mexican American and Anglo American, *Sociometry,* 1976, *39,* 209-222.

Banfield, Edward C. *The Unheavenly City Revisited.* Boston: Little, Brown, & Co., 1974.

Brown, Jerald B. *The United Farm Workers Grape Strike & Boycott: An Evaluation of the Culture of Poverty.* Ithaca, NY: Cornell University Press, 1972.

Gordon, Milton. *Assimilation in American Life: The Role of Race, Religion and National Origin.* New York: Oxford University Press, 1964.

Henggeler, Scott W. & Tavormina, Joseph. The children of Mexican American migrant workers: A population at risk, *Journal of Abnormal Child Psychology,* 1978, *6,* 97-106.

Lopez, David. The social consequences of Chicano home/school bilingualism, *Social Problems,* 1976, *24,* 234-246.

Lopez, David. Chicano language loyalty in an urban setting, *Sociology and Social Research,* 1978, *62,* 267-278.

Nachimas, Chava. Community and individual ethnicity: The structural context and economic performance, *American Journal of Sociology,* 1979, *85,* 640-652.

Patella, Victoria & Kuvlesky, William. Situational variations in language patterns of Mexican American boys and girls, *Social Science Quarterly,* 1973, *53,* 855-864.

Rodriguez, Richard. *Hunger of Memory: The Education of Richard Rodriguez.* Boston: Godine, 1982.

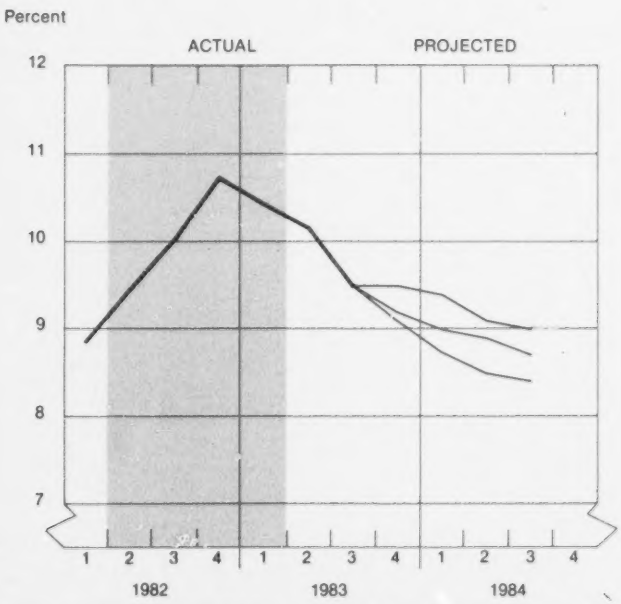
S.E.R. Jobs for Service Inc. *Hispanics and the Labor Market: A Critical Perspective.* Dallas, TX: SER Planning and Research Division, 1980.

Skrabanek, R.L. Language maintenance among Mexican Americans, *International Journal of Comparative Sociology,* 1970, *11,* 272-282.

Wilson, Kenneth & Portes, Alejandro. Immigrant enclaves: An analysis of the labor market experiences of Cubans in Miami, *American Journal of Sociology,* 1980, *86,* 295-319.

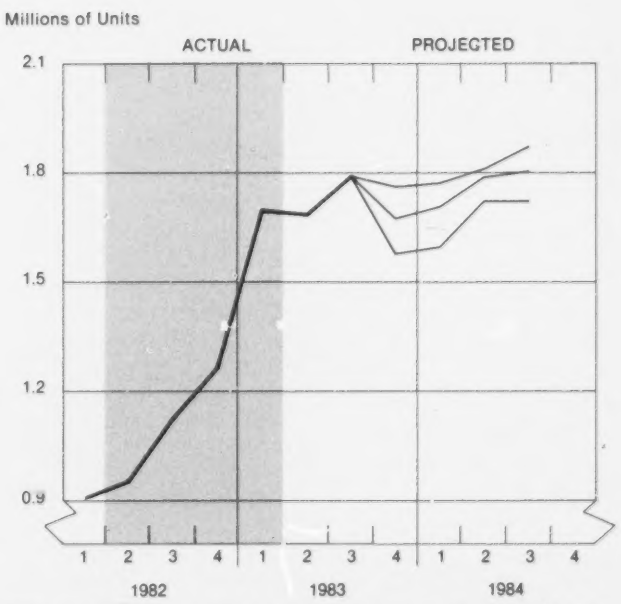
Yancey, William; Erikson, Eugene; & Julian, Richard. Emergent ethnicity: A review and reformulation, *American Sociological Review,* 1976, *41,* 391-403.

UNEMPLOYMENT RATE



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

NEW PRIVATE HOUSING UNITS STARTED



Note: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Author Index to Volume 10 (1983)

Arce, Carlos H., and Torres, David L.
The Effects of Cultural Assimilation and Education on Mexican American Workers' Earnings 4/87*

Bachman, Jerald G.
Premature Affluence: Do High School Students Earn too Much? 3/64

Barfield, Richard E.
Some Economic Policy Opinions of Business Economists 1/15
Results from the February NABE Survey 2/39
Results from the May NABE Survey 3/59
Results from the August NABE Survey 4/81

Curtin, Richard T.
Buying Attitudes Improve 1/12
Surge in Consumer Optimism 2/34
Consumer Optimism Reaches Decade Peak 3/51
Comsumer Optimism Maintained at Record Level 4/78

Hill, Martha S., and Ponza, Michael
Poverty and Welfare Dependence Across Generations 3/61

Hymans, Saul H., and Crary, Joan P.
The U.S. Economic Outlook for 1983: April Update 2/30
Midyear Review and Forecast: The U.S. Economic Outlook for 1983-84 3/55

Hymans, Saul H., Crary, Joan P., and Howrey, E. Philip
The U.S. Economic Outlook for 1983 1/03

Juster, F. Thomas
Whither the Recovery? 4/75

McCracken, Paul W.
The Swallows of Spring 1/10

Saulnier, Raymond J.
An Urgent Task: To Reduce the Federal Budget's Structural Deficit 2/27

Strumpel, Burkhard
Dual Economy: Nightmare or Model for the Future? 2/41

Zarnowitz, Victor
The Economy and the Forecasts after a Bad Year 1/17
Some Lessons from Research in Macroeconomic Forecasting 4/83

*Issue number/beginning page number

Actual and Projected Economic Indicators

seasonally adjusted

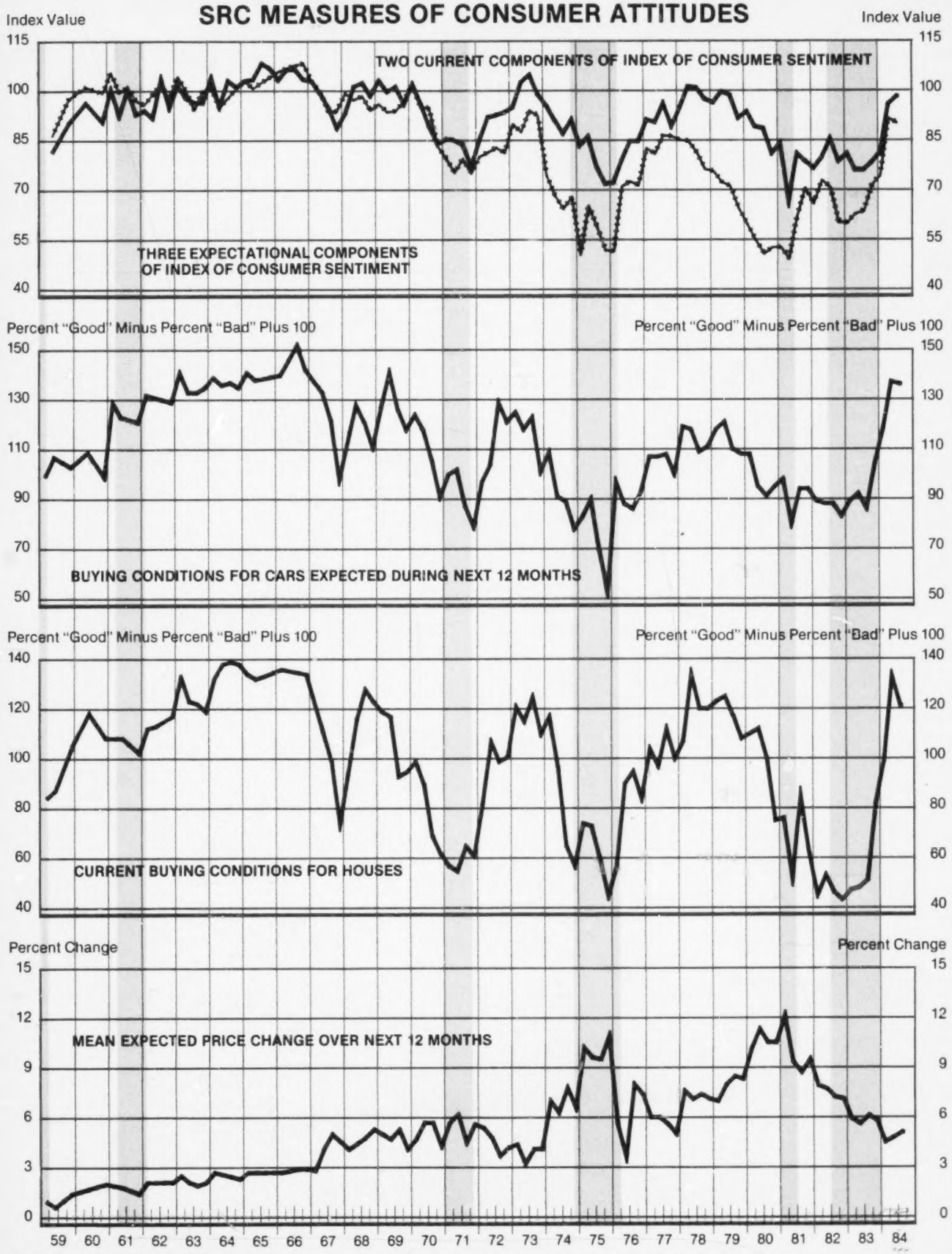
SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Act'l.	Projected	
	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1983:3	1983:3	1983:4	1984:1	1984:2	1984:3	1982	1983	1984
GROSS NATIONAL PRODUCT	3,021	3,070	3,091	3,110	3,172	3,272	3,363	3,359	3,431	3,510	3,585	3,660	3,073	3,308	3,624
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	203.4	206.1	208.0	210.0	212.8	214.6	216.4	217.2	219.7	222.4	225.0	227.8	206.9	216.2	226.6
CORPORATE PROFITS AFTER TAXES	112.9	117.4	116.5	113.5	108.2	127.2	NA	138.0	144.6	148.0	156.0	161.5	115.1	129.0	160.0
UNEMPLOYMENT RATE (percent)	8.80	9.40	9.97	10.67	10.37	10.10	9.43	9.50	9.20	9.00	8.90	8.70	9.71	9.80	8.80
INDUSTRIAL PRODUCTION (index, 1967 = 100)	141.8	139.4	138.2	135.3	138.5	144.5	151.6	149.0	151.3	154.0	156.0	158.0	138.6	146.0	157.6
NEW PRIVATE HOUSING UNITS STARTED (millions)	0.903	0.950	1.122	1.261	1.694	1.683	1.788	1.650	1.592	1.623	1.700	1.715	1.059	1.663	1.700
CONSUMER PRICE INDEX (% change from prior quarter or year)	3.0	5.3	7.8	2.0	-0.4	4.2	4.8	4.5	4.5	4.6	4.5	4.4	6.2	3.2	4.5
3-MONTH TREASURY BILL RATE (%)	12.90	12.36	9.71	7.94	8.08	8.42	9.19	9.18	9.03	8.90	8.68	8.90	10.72	8.70	8.90
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	16.14	15.65	14.72	12.22	11.99	11.57	NA	12.10	12.20	11.95	11.70	11.70	14.68	11.80	11.80
GNP IN 1972 DOLLARS	1,486	1,489	1,486	1,481	1,490	1,525	1,554	1,547	1,564	1,579	1,597	1,611	1,485	1,531	1,604
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	961	969	971	980	987	1,011	1,019	1,022	1,031	1,041	1,052	1,060	970.2	1,012	1,056
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	173.6	167.1	163.3	160.5	159.9	163.0	168.7	163.0	165.0	167.0	170.0	173.2	166.1	162.8	171.4
RESIDENTIAL FIXED INVESTMENT (1972 $)	36.3	37.8	36.5	40.6	45.5	52.6	56.9	54.0	54.0	54.0	55.0	56.9	37.8	51.5	56.0
CHANGE IN BUSINESS INVENTORIES (1972 $)	-10.2	-3.4	-1.3	-22.7	-15.4	-5.4	4.8	2.0	6.5	8.0	10.0	10.2	-9.4	-2.9	10.0
NET EXPORTS (1972 $)	35.2	33.4	24.0	23.0	20.5	12.3	8.7	8.3	8.0	8.9	8.0	8.0	28.9	12.0	8.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	114.5	110.3	116.9	124.4	118.4	117.6	119.6	120.3	123.0	124.4	126.6	127.0	116.5	120.0	127.0
STATE & LOCAL GOVERNMENT PURCHASES (1972 $)	174.9	175.4	175.3	175.2	174.5	174.5	176.6	174.2	175.0	175.5	176.0	176.5	175.2	174.4	176.0

SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1980:4	1981:1	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1983:3	1980	1981	1982
GROSS NATIONAL PRODUCT	2,736	2,867	2,913	3,005	3,032	3,021	3,070	3,091	3,110	3,172	3,272	3,363	2,632	2,954	3,073
PERSONAL CONSUMPTION EXPENDITURES	1,742	1,803	1,836	1,886	1,904	1,939	1,973	2,009	2,047	2,073	2,147	2,186	1,668	1,857	1,992
GROSS PRIVATE DOMESTIC INVESTMENT	411.7	455.5	472.1	495.8	476.2	422.9	432.5	425.3	377.4	404.1	450.1	501.0	401.9	474.9	414.5
NET EXPORTS	23.3	31.9	21.1	22.8	29.2	29.9	33.3	0.9	5.6	17.0	-8.5	-25.9	23.9	26.3	17.4
GOVERNMENT PURCHASES	559.0	576.3	583.5	600.3	622.8	629.8	631.6	655.7	679.7	677.4	683.4	701.8	537.8	595.7	649.2
DISPOSABLE PERSONAL INCOME	1,908	1,968	2,010	2,092	2,121	2,128	2,159	2,192	2,228	2,256	2,301	2,362	1,829	2,048	2,177
PERSONAL SAVING RATE (% of disposable income)	6.0	5.7	6.0	7.2	7.5	6.1	5.9	5.6	5.4	5.4	4.0	4.7	6.0	6.6	5.8

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late October, and projected data, released by ASA-NBER in September, are displayed for third quarter 1983.

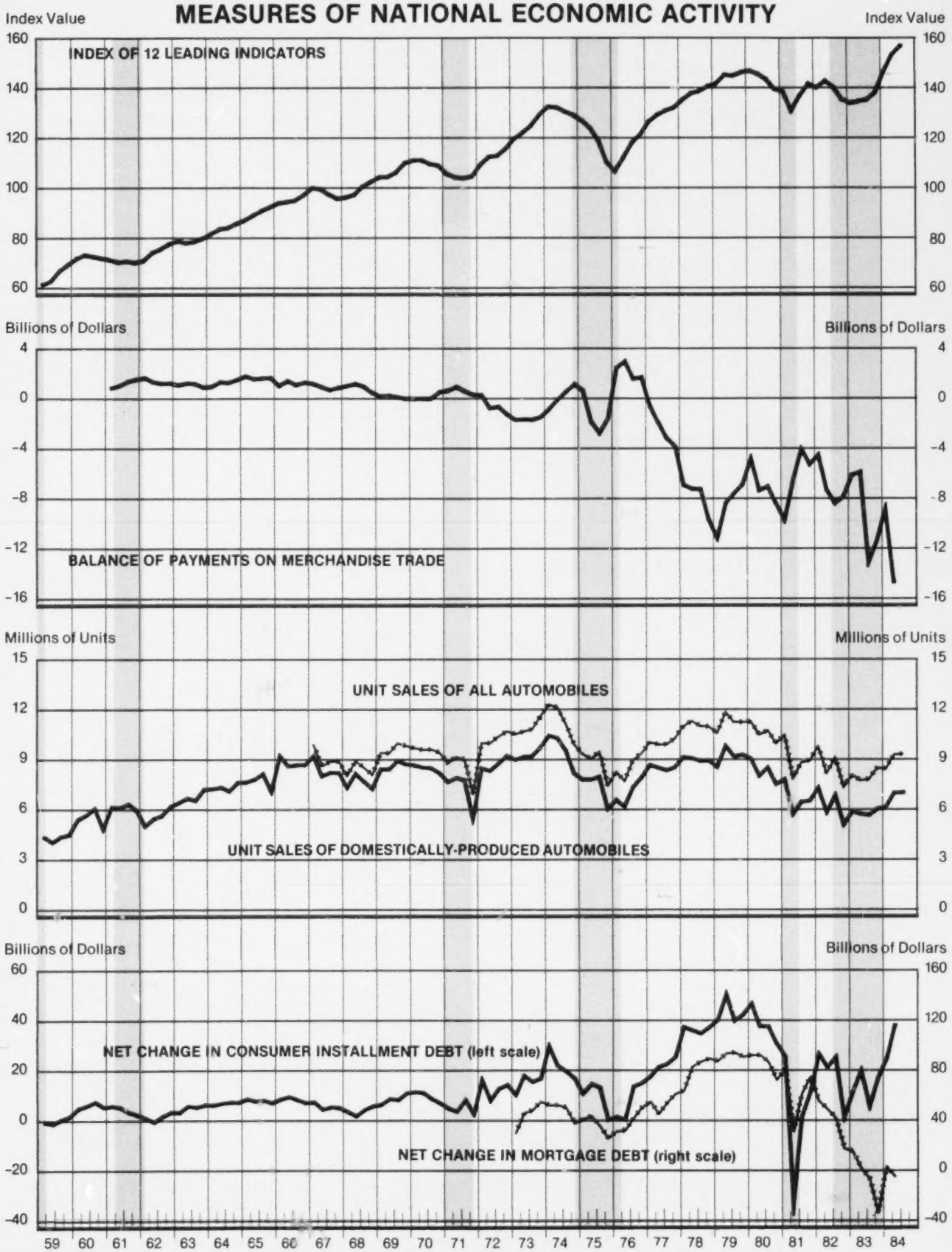
Sources: Projections: American Statistical Association–National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

SRC MEASURES OF CONSUMER ATTITUDES


Index Value
Index Value
TWO CURRENT COMPONENTS OF INDEX OF CONSUMER SENTIMENT
THREE EXPECTATIONAL COMPONENTS OF INDEX OF CONSUMER SENTIMENT
Percent "Good" Minus Percent "Bad" Plus 100
Percent "Good" Minus Percent "Bad" Plus 100
BUYING CONDITIONS FOR CARS EXPECTED DURING NEXT 12 MONTHS
Percent "Good" Minus Percent "Bad" Plus 100
Percent "Good" Minus Percent "Bad" Plus 100
CURRENT BUYING CONDITIONS FOR HOUSES
Percent Change
Percent Change
MEAN EXPECTED PRICE CHANGE OVER NEXT 12 MONTHS
59 60 61 62 63 64 65 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84

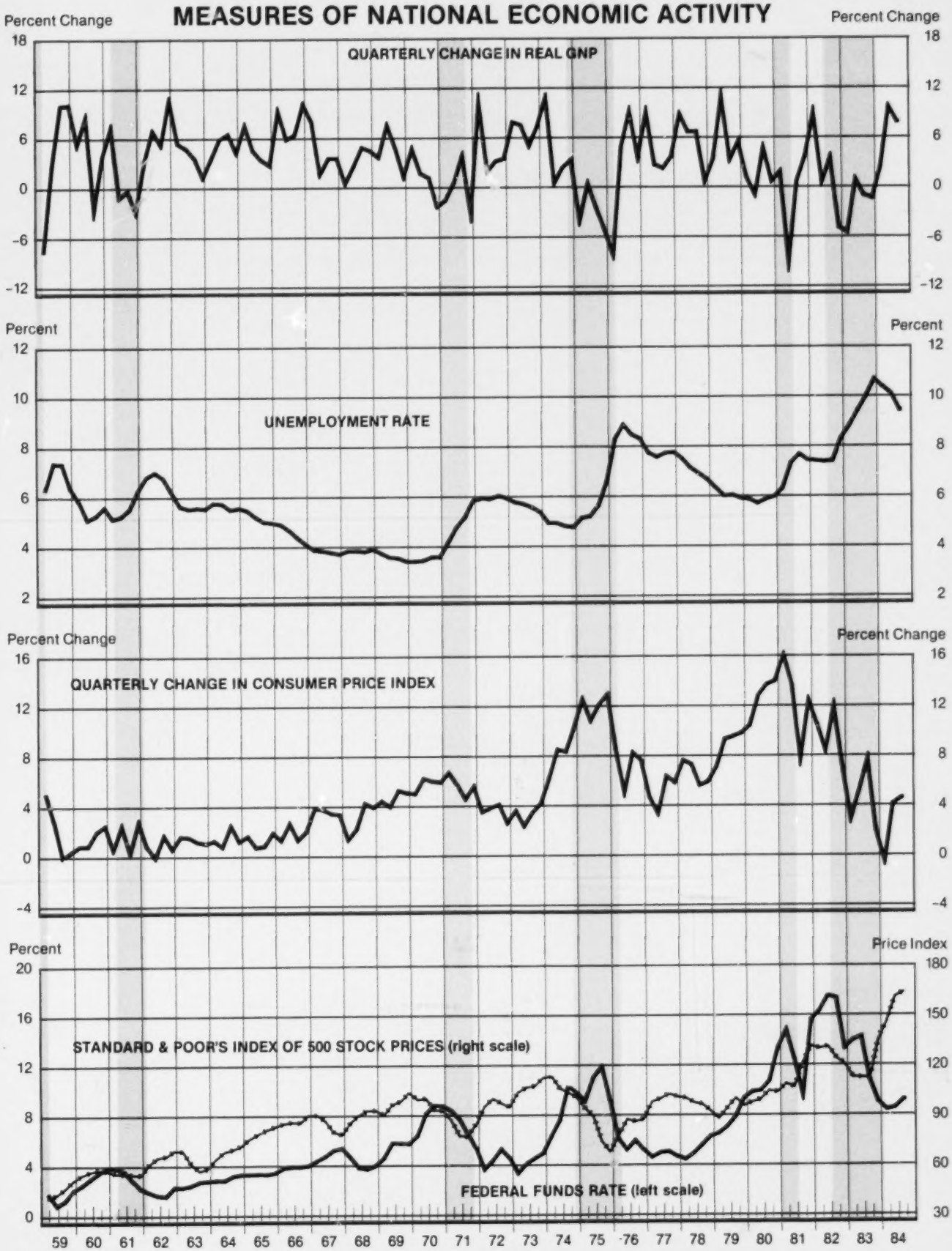
Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Announcing an important new volume from the Institute for Social Research

The Impact of Work Schedules on the Family

by Graham L. Staines and Joseph H. Pleck
with a foreword by Urie Bronfenbrenner

This new volume presents the findings from the first systematic study of the effects of work schedules on family stress. Authors Graham L. Staines and Joseph H. Pleck investigate the nature and characteristics of contemporary patterns of work schedules for married couples (with and without children) and for single-parent families and describe the effects of these work patterns on family life.

This study is the first to give specific attention to the way husbands' and wives' work schedules interact and influence family life for each of them. The volume offers new knowledge about the psychological effects of some of the major changes taking place in American society, including the influx of women into the paid work force and the concomitant rise in the number of dual-earner couples. It offers critical insight into what may be one of the most salient social issues of the future.

The authors look at the relationship of people's work schedules to the amount of time spent in specific family roles (taking care of children or doing housework, for example), perceptions of interference between work and family roles, and levels of family adjustment and conflict.

The findings are based on the survey responses from a large national sample (2,850 American households) and reflect the actual distribution of different types of work schedules among the population.

This innovative research includes a close examination of four aspects of the work schedule: patterns of days worked each week, patterns of hours worked each day, number of hours worked each week, and schedule flexibility. It gives careful attention to both the separate and combined effects of these variables on specific aspects of family life.

The authors reach important conclusions about many areas within the domains of work and family, particularly about the critical relationships between people's sense of flexibility and control over their own work schedules and the resulting levels of stress or satisfaction within their families.

1983 / 186 pages / ISBN 0-87944-284-0 / clothbound $22

Order from:

ISR Publications Sales
Institute for Social Research
The University of Michigan
P.O. Box 1248
Ann Arbor, MI 48106

All orders from individuals must be prepaid.

ECONOMIC OUTLOOK USA SRC—P.O. Box 1248 Ann Arbor, MI 48106

5/30/84 U7475-3 A

ECONOMIC OUTLOOK USA

WINTER 1984
Vol. 11 No. 1

A quarterly publication of the
SURVEY RESEARCH CENTER
Institute for Social Research
THE UNIVERSITY OF MICHIGAN

1984 FORECAST ISSUE

Hymans, Crary, and Howrey
The U.S. Economic Outlook for 1984
Gardner Ackley
The Economic Outlook and Economic Policy
Paul W. McCracken
The Return of Sustained Expansion?
Richard T. Curtin
Optimism Rides High Plateau
Richard E. Barfield
Results from the November NABE Survey

ECONOMIC OUTLOOK USA (USPS 330-690)
WINTER 1984 Vol. 11 No. 1

Published Quarterly by the
SURVEY RESEARCH CENTER
THE UNIVERSITY OF MICHIGAN
426 Thompson Street
P.O. Box 1248
Ann Arbor, Michigan 48106

EDITOR'S NOTE:

ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis in this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

The opinions expressed in this publication represent those of individual authors and do not necessarily reflect the views of the Survey Research Center or The University of Michigan. The editor, as a matter of policy, makes no attempt to reconcile divergent opinions.

SUBSCRIPTIONS:

Regular Subscribers, $27.00 U.S. per year
Academic Subscribers, $13.00 U.S. per year (available to *individual faculty and students* only)

Quantity subscriptions are available at substantial discounts. For 1-99 subscriptions, contact the Circulation Manager at the Survey Research Center address (phone: 313–763-5169). Subscribers to 100 or more copies may use their own imprint on the front cover and may use the back cover for a message to customers, executives, and others. Direct inquiries to the Executive Editor at the Survey Research Center (phone: 313–763-5196).

EDITOR: F. Thomas Juster
EXECUTIVE EDITOR: Richard Barfield
CIRCULATION MANAGER: Nellie Beaubien

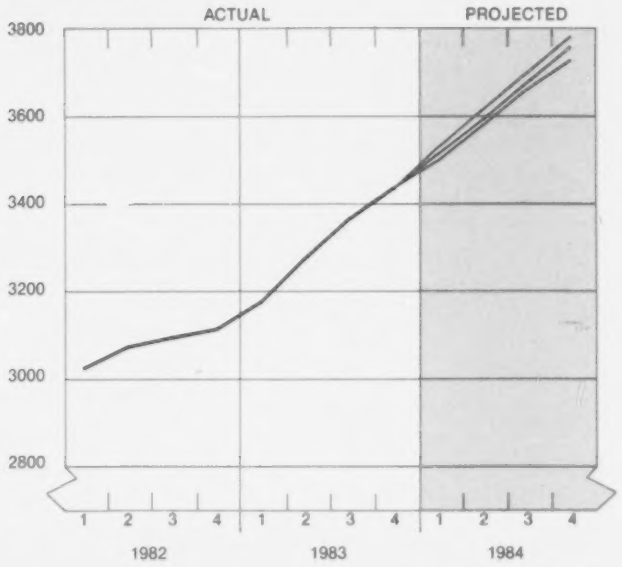
Editorial Board:
Richard Barfield
Richard T. Curtin
F. Thomas Juster
Paul W. McCracken
James N. Morgan
Burkhard Strumpel
Victor Zarnowitz

© 1984 by The University of Michigan. Second-class postage paid at Ann Arbor, Michigan. **Postmaster:** send address changes to ECONOMIC OUTLOOK USA, at the address given above. Printed in the U.S.A.

ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT

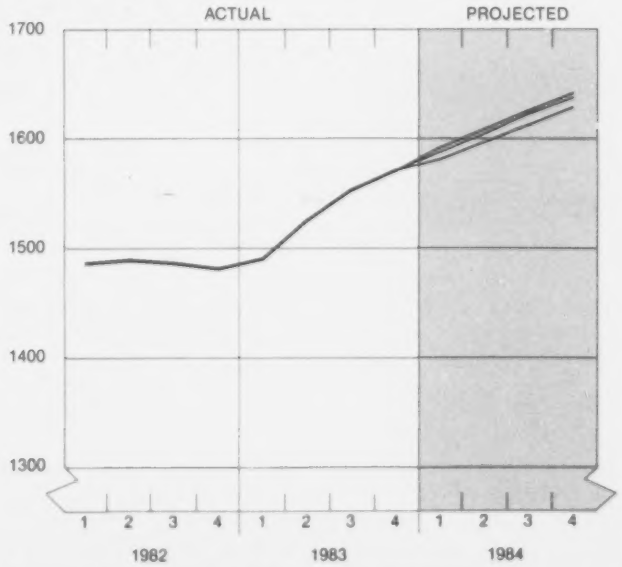
IN CURRENT DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

The U.S. Economic Outlook for 1984

Saul H. Hymans, Joan P. Crary, and E. Philip Howrey
Research Seminar in Quantitative Economics
Department of Economics
The University of Michigan

Review of the Forecast for 1983

At the Economic Outlook Conference held one year ago, we concluded that real GNP would grow by 3.4 percent for 1983. That forecast put us out on a fairly isolated limb. When it appeared a few weeks later in Robert Eggert's *Blue Chip Economic Indicators,* it ranked as the eighth most optimistic out of 43 forecasts of real GNP for 1983. Closest to us among major economic model forecasts was the Wharton forecast, which sat about midway in the Eggert ranking with a predicted growth rate of 2.8 percent (also the consensus forecast for that period). Based on the data available for the first three quarters of this year and our present forecast for the balance of the year, we are now estimating that real GNP for 1983 as a whole will wind up 3.5 percent above its 1982 level. Translated into billions of 1972 dollars, that amounts to a $51.8 billion rise in real GNP for 1983, compared to our forecast of $50.7 billion made a year ago.

Pleasurable as it is to begin a forecast evaluation by noting that we had the total just about right, that is hardly a sufficient basis on which to judge the overall quality of the forecast. Two other aspects of considerable importance to the potential usefulness of a forecast are how well it explains the sectoral detail accompanying the aggregates, and how well it captures the dynamic path of the economy. The former aspect—the matter of underlying detail—is addressed in Table 1. Looking first at the components of the change in real GNP, it is clear that our forecast was extremely accurate in its representation of the changes in consumer purchases of nondurables and services, business purchases of equipment and structures, residential construction activity, government purchases, and inventory accumulation.

We were less accurate in our prediction of the change in consumer purchases of durable goods, where we were low by almost $7 billion (1972 dollars); and we were even farther off in the case of real net exports of goods and services, where our error amounted to an over prediction of about $12½ billion. Little of the error in our forecast of consumer durables was due to misjudging total car sales; on the contrary, we believe that our forecast of 9.1 million car sales in 1983 will turn out to be almost exactly correct. With regard to net exports, the major part of our forecast error occurred on the export side of the account. A year ago we believed that U.S. exports would not continue to weaken beyond the point reached in 1982:3 and that the level of exports would remain nearly constant for the balance of 1982 and most of 1983. We expected virtually no export growth until late in 1983. What our forecast missed completely was a further sharp drop in exports in the closing quarter of 1982, after which real exports did indeed remain virtually flat for most of 1983—but at a level more than $10 billion below that which we had anticipated.

By all available measures 1983 has been a year of marked reduction in the rate of inflation, and our forecast clearly underestimated the extent of the improvement. This has in fact been the third straight year of substantially reduced inflation. We have gone from double-digit inflation in 1980, to an 8½ percent rise in consumer prices in 1981, to about 6 percent in 1982, and to only about 4 percent this year. Getting to this state of relatively low inflation has, of course, been extremely costly in human terms, as the 1981-82 recession produced the highest unemployment rates in forty years.

While the rate of inflation came down by more than we had anticipated, interest rates dropped by less. At this time last year 3-month treasury bills were yielding about 8 percent—well below their levels of a few months earlier—and we were forecasting a further decline to an average of about 7 percent for 1983. That proved to be too optimistic in a manner which our discussion of the dynamics of the forecast, to which we now turn, reveals.

TABLE 1. Review of RSQE Forecast for 1983

	1981-82	1982-83	
Economic Indicator	**Actual[1]**	**Actual[2]**	**Predicted[3]**
Changes:			
Real GNP & Components (billions 1972 dollars)			
GNP	−28.4	51.8	50.7
Personal Consumption	13.5	41.1	31.0
Durable Goods	−1.3	15.9	9.0
Nondurables & Services	14.8	25.2	22.0
Business Fixed Investment	−8.3	0.5	−2.5
Residential Construction	−6.8	15.8	12.8
Inventory Investment	−17.9	8.4	8.8
Net Exports	−14.1	−17.3	−4.7
Government Purchases	5.3	3.4	5.0
Wages & Prices (% changes)			
Hourly Compensation, private nonfarm sector	7.9	5.7	6.2
Price Deflator, private nonfarm sector	5.9	3.8	4.6
Personal Consumption Deflator	5.8	4.0	5.6
Consumer Price Index	6.2	3.3	5.9
Levels in Terminal Quarter:			
Civilian Unemployment Rate (%)	9.7	9.7	10.1
3-Month Treasury Bill Rate (%)	10.6	8.6	6.9
Corporate Aaa Rate (%)	13.8	12.0	11.2
Auto Sales (millions of units)	8.0	9.1	9.1
Private Housing Starts (thousands of units)	1059	1693	1618
Corporate Profits[4] (% of GNP)	5.4	7.0	7.1

[1]Based on data published by official agencies (U.S. Departments of Commerce and Labor, Federal Reserve Board, etc.).
[2]First three quarters of 1983 based on data published by official agencies; fourth quarter of 1983 as forecast by RSQE in November 1983.
[3]RSQE forecast released in November 1982.
[4]Includes inventory valuation and capital consumption adjustments.

The forecast for 1983 produced a somewhat smoother GNP growth path than is now estimated to have occurred, but it captured the overall contour reasonably well and the cumulated change in real GNP from late 1982 to late 1983 extremely well. Our error in forecasting the quarterly pattern in the unemployment rate was relatively minor and consistent with the timing errors in our real GNP forecast.

Our overestimate of the rate of inflation in 1983 stems primarily from missing the dramatic reduction in the rate of inflation which occurred in the late winter and early spring of this year. A good deal of that may prove to have been the transitory benefit of a number of favorable special factors, including temporary weakness in food, oil, and other crude materials prices.

In forecasting the path of interest rates last year, we were anticipating that the Federal Reserve Board would be pushing rates lower not only to continue supporting the domestic recovery, but also to provide for lower cost refinancing of third world debt to American and other Western banks. The Fed pulled up quite short of what we had expected in this regard and appears, on the contrary, to have been nudging interest rates upward after the early months of the year and until sometime into the summer. From the reports of a number of bankers, as well as the Fed's own data on member bank borrowings, the 8½ percent discount rate was largely a fiction during the spring and early summer. The Fed simply closed the window to many willing borrowers—in effect tightening credit without advertising it and thereby pushing up interest rates.

The Current State of the Economy

As we read the indicators relevant to the current state of economic activity, it seems clear that a strong upward momentum is still operating. New orders for nondefense capital goods are rising sharply, personal income is increasing rapidly, consumer sentiment is at record or near-record levels both among higher and lower income families, and the early reports on October retail trade indicate strong gains. Domestic auto sales are pressing hard on the available supply, and the auto companies are scheduling high levels of production to raise the flow of cars to the dealer network. Manufacturing production has risen at a 22 percent annual rate in the past three months, while capacity utilization has recovered to 78.4 percent. Civilian employment reached nearly 102 million in September, a gain in excess of 1.1 million workers since June and 2.8 million since the turn of the year. By the end of October, various short-term interest rates had dropped some 50-100 basis points compared with their mid-August levels, and long-term rates had edged down by 20-30 basis points.

All told, these initial conditions fairly guarantee a strong economic performance in the closing quarter of 1983. We are forecasting that the fourth quarter of 1983 will register an annualized growth rate of 6.5 percent, down somewhat from the estimated third quarter growth rate but still very strong indeed. In consumer purchases, business investment, and government purchases, the third and fourth quarter gains are nearly alike. Residential building and net exports are the sectors which account for the small drop-off in the fourth quarter growth rate. The real net export balance is forecast to fall by about $4 billion (annual rate) as imports continue to rise while exports remain nearly flat. Residential building is forecast to be up in the fourth quarter, but by only about half as much as in the third quarter, as the spring/summer run-up in interest rates has taken some of the steam out of the housing recovery.

Inflation is expected to remain moderate in the fourth quarter, while the civilian unemployment rate is expected to average 8.9 percent for the quarter.

The drop in short-term interest rates which began in mid-August as the Fed allowed credit conditions to ease a bit has brought the treasurey bill rate to an 8.7 percent average for October, and we are forecasting that these rates will continue to edge downward—on average—for at least the next several months.

Thus we see 1983 ending with the economy still on a steep growth path and characterized by conditions which are likely to continue the pattern of substantial growth into the early months of 1984. Before extending the outlook into the 1984-85 period, we turn to a discussion of the input assumptions which are of major importance in shaping our forecast of economic activity for the next several years.

Inputs to the Forecast

The *federal expenditure* assumptions in our forecast are summarized in Table 2. The latest available data indicate that federal spending in the National Income and Product Accounts totalled $819.6 billion in fiscal 1983, up $79 billion from the previous fiscal year. We are assuming total expenditure increases of about $57 billion and $71 billion for fiscal years 1984 and 1985, respectively. The item in the budget which accounts for most of the expenditure slowdown in fiscal 1983, are forecast to decline by more than $9 billion in fiscal 1984 is transfer payments. This category, which contains the bulk of the social program spending of the federal government, increased by $34 billion in FY 1983 and is projected to rise by only $9 billion in the current fiscal year.

TABLE 2. Federal Government Expenditures and Receipts (National Income and Product Accounts, billions of dollars)

Expenditures, Receipts, and Deficit	Fiscal 1983[1]	Fiscal 1984[2]	Fiscal 1985[2]
Total Expenditures	819.6	876.0	947.5
Purchases of Goods and Services	276.9	301.0	332.3
National Defense	197.6	221.6	245.5
Nondefense	79.3	79.4	86.8
Transfer Payments	344.0	352.9	373.1
Grants-in-Aid to State and Local Governments	86.0	87.9	90.3
Net Interest Paid	92.5	115.6	132.8
Subsidies less Current Surplus of Gov't. Enterprises	19.8	19.0	19.0
Less: Wage Accruals less Disbursements	−0.4	0.4	0
Total Receipts	634.2[3]	705.4	791.1
Deficit (−)	−185.4	−170.6	−156.4

[1]Data for Fiscal 1983 are from the *Survey of Current Business*, October 1983.
[2]RSQE projections and forecasts for fiscal years 1984 and 1985.
[3]Receipts and Deficit for 1983:3 are RSQE Projections.

Some $17 billion of this difference results from the fact that unemployment insurance benefits, which increased by $7½ billion in fiscal 1983, are forecast to decline by more than $9 billion in fiscal 1984. The balance is accounted for primarily by the decision to eliminate half a year's worth of the normal increase in benefit payments to social security recipients. The benefit increase, which is tied to the rate of inflation and would normally have been paid on July 1, 1983, was pushed back to January 1, 1984, with no make-up for the half-year of delay. We are assuming that defense spending will continue to rise rapidly but at a diminishing rate of increase over the next two fiscal years. The non-compensation component of defense spending rose by 20.7 percent in FY 1982 and by 18.9 percent in FY 1983; we are assuming increases of 16 percent and 11 percent in fiscal years 1984 and 1985, respectively, which imply corresponding real increases of about 8 percent and 3 percent.

With regard to *federal taxes,* our forecast assumes no major changes in tax legislation. That implies, of course, that the full Reagan tax cut program remains in effect and that inflation indexation of the federal personal tax structure begins in January 1985, as scheduled. In effect the indexed tax system will continue to tax the usual nominal tax base, but at tax rates determined by the growth of the *real* tax base after 1984. The indexed system will be in effect for the final three quarters of fiscal 1985 and, by our calculations, will produce a net federal revenue loss of $5 billion in that fiscal year. The size of the revenue loss rises substantially over time, however, as the price level continues to rise; and we calculate that the net revenue loss in the second fiscal year of the indexed system—fiscal 1986—will increase to about $22 billion dollars, or the equivalent of about another 7 percent cut in personal income taxes by fiscal 1986.

The net result of the assumed federal budget and the rest of our input assumptions is an economic forecast which produces the *federal deficit path* shown in the bottom line of Table 2: successive reductions in the deficit amounting to about $15 billion in each of the next two fiscal years. Adjusting for the size of the economy, this implies that the deficit will slip from 5.7 percent of GNP in fiscal 1983 to 4 percent of GNP in fiscal 1985.

In recent years the monetary authorities have been extremely active in their pursuit of what has, on the average, been a rather restrictive set of credit conditions. From about 1978 to mid-1982—with a brief hiatus in mid-1981--the Fed pursued a tight money policy in order to beat double-digit inflation and lower inflationary expectations. The Fed switched to easier credit conditions in order to support economic recovery and, simultaneously, to ease the refinancing of less-developed-country debt to Western banks from mid-1982 to about the spring of 1983. Concurrently, however, the federal budget was turning substantially expansionary under the impetus of the administration's three-year tax cut program. In apparent reaction to money market fears and the potential inflationary impact of the resulting long-term or structural imbalance in the federal budget, the Fed backed off its expansionary policy this spring with the result that interest rates moved up by 100-150 basis points between May and August of this year. The Fed again reversed direction in the late summer—but by enough to reverse no more than half of the earlier run-up in interest rates.

The basic conclusion which we draw from this brief narrative on Fed policy is that the monetary authorities are unlikely to run much of a risk of erring on the expansionary side. As long as the economy is heading upward under the stimulus of a basically expansionary federal budget, inflation—or the potential for a resurgence of inflationary expectations—will remain the enemy. The credit markets will be on notice that a persistent imbalance in the federal budget will not be permitted to drive the economy into a state of excess aggregate demand and accelerating inflation. The further implication, of course, is the persistence of relatively high interest rates—not because of inflation but, on the contrary, because the Fed will keep rates at a relatively high level precisely to avoid inflation. The quantitative translation of our sense of the likely course of *monetary policy* is that

- the monetary base will follow a path averaging 5 percent growth per year during 1984 and 1985, and
- the discount rate will remain fixed at its current level of 8½ percent.

The fiscal and monetary policies assumed in our forecast constitute a policy mix biased against such sectors as the automobile and housing markets, and construction activity in general. Further, by keeping the international value of the U.S. dollar relatively high, the high interest rate policy favors imports over domestic production across a broad spectrum of commodities. In a direct, simplistic sense massive personal tax cuts clearly favor the private sector. But if such tax cuts outstrip the desirable and politically feasible extent to which expenditures can be held down, the true implications of the tax cut policy are far more complicated and likely even to be quite different from that which may have been intended.

For much of the past year the U.S. inflation rate has benefited from weakness—if not declines—in a number of basic prices including those for petroleum, crude industrial materials, lumber, and various agricultural commodities. To the extent that this has been the result of the severity of the 1981-82 recession both in the U.S. and in most of the rest of the Western economies, it cannot be expected to continue. We are assuming that most such prices will be increasing at more rapid rates over the next two years as economic growth continues and the markets for basic commodities begin to tighten.

In the case of *crude oil* we have assumed an annual inflation rate building up from the 4-5 percent range in the very near term to 6 percent by mid-1984 and 7 percent by early 1975. We are assuming that the price of *natural gas,* which has been particularly weak recently, will be increasing at a rate of about 8½ percent on the average over the next two years. *Other crude materials prices* are assumed to increase at a 7 percent annual rate until mid-1984, at an 8 percent rate from mid-1984 to early 1985, and at a 9 percent rate thereafter.

In the case of *farm prices,* we have assumed that last summer's drought will cause a bulge in the rate of farm price inflation to 8 percent at annual rate from the spring through the winter of 1984. If the primary effect of the drought (and the PIK program) is to reduce to "about normal" the carryover stock levels which had risen dramatically during the past few years, and the 1984 growing seasons result in normal production levels, farm price inflation can be expected to drop in 1985. At this point, we have assumed a modest decline to a 7 percent rate of increase of farm prices in 1985.

As might be judged from hints contained in the foregoing discussion, we are not expecting *the dollar* to weaken significantly in international markets over the horizon of this forecast. The expected pattern of domestic interest rates is consistent with continued strength for the U.S. dollar. The

likelihood that foreign central banks will want to follow U.S. interest rates closely to the extent that the latter might decline is, again, consistent with the view that the dollar will remain generally strong. Further, the political and economic turmoil afflicting so many parts of the world has resulted in the U.S. dollar's appearing to be among the few safe havens for financial investment, and this is likely to continue to enhance the value of the dollar. In our judgment, this combination of factors is likely to be strong enough to counterbalance the weakness of the dollar which should otherwise emerge due to the progressive deterioration of our trade balance.

With respect to *exports of goods and services* from the U.S., we are assuming a pattern of real growth building up to an annual rate of 3½ percent by mid-1984, due primarily to approximate stability of the other major currencies relative to the dollar and a moderate economic recovery abroad. In the context of our forecast, this assumption results in a continual increase in our trade deficit from the $14 billion projected for this year to over $50 billion (in current prices) for calendar 1984 and to $70 billion for calendar 1985.

We turn now to a systematic review of the 1984-85 economic outlook as it results from processing the initial conditions and our input assumptions through the Michigan Quarterly Econometric Model of the U.S. Economy.

Overview of the Forecast

Our forecast for 1984-85 is summarized in Chart 1. The 3½ percent growth of real GNP now estimated for 1983 is forecast to be followed by a 6½ percent increase in total national output in 1984 and a 4.2 percent increase in 1985. Measured on a fourth quarter to fourth quarter basis, we are forecasting that real GNP will rise by 5.6 percent during 1984—compared with 6.6 percent during 1983—and by 3.2 percent during 1985.

This substantial growth of production is forecast to be accompanied by a reduction in the civilian unemployment rate to an average of 8.3 percent for calendar 1984 and 7½ percent for 1985.

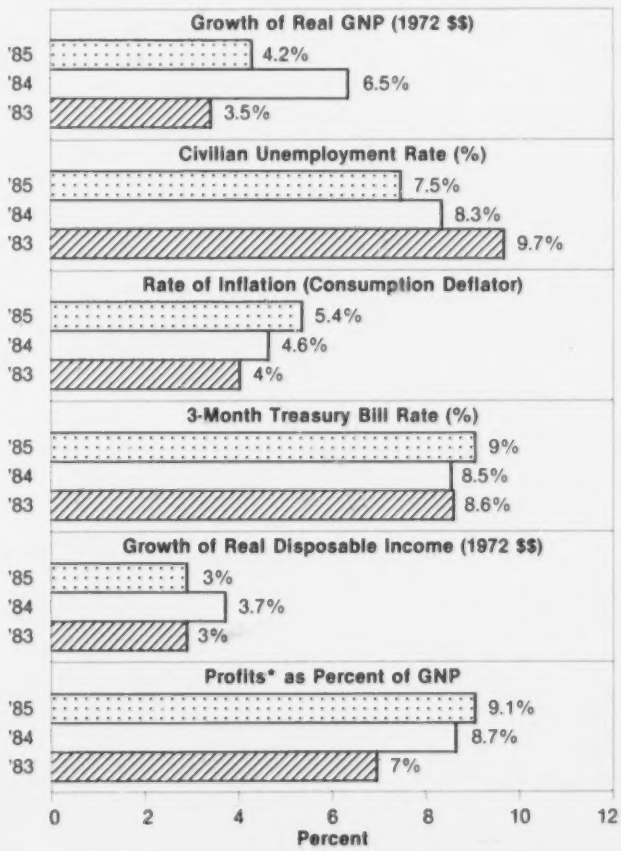
The gains in output and employment over the next two years cannot be expected to be entirely costless on the inflation side. The average level of consumer prices (implicit deflator) in 1984 is forecast to be 4.6 percent higher than in 1983—up moderately from the 4 percent increase estimated for 1983 as a whole. The year 1985, however, is forecast to register a 5.4 percent increase in the average level of consumer prices.

It is worth noting the context of the inflation pattern which we are forecasting in order to put it into reasonable historical perspective. Between 1983 and 1985 the unemployment rate is expected to decline by about 2.2 percentage points from a very high level associated with a severe recession. Over the same two years the concomitant tightening of markets—without any major supply shocks, up or down—is forecast to add almost 1½ percentage points to the rate of inflation. That short-run trade off is considerably better than was experienced during the comparable 1976-78 period, when the unemployment rate declined by 1.6 percentage points to the accompaniment of an increase of almost 2 percentage points in the rate of inflation—and that was before the second OPEC shock. On the other hand, the trade off predicted for 1983-85 is not nearly as favorable as that which accompanied the recovery from the severe recession which ended in 1958:1. The unemployment rate dropped by 1.3 percentage points from 1958 to 1960, and the rate of inflation remained virtually constant at about 2 percent! When it comes to inflation, the mid-seventies experience is clearly the more relevant to our current situation. The major benefit deriving from the circumstances and severity of the 1981-82 recession may well be that we now have in place better initial conditions vis-à-vis restraint of inflation than we had following the 1974-75 recession.

Turning to the forecast for interest rates, we expect that the average level of short-term interest rates in 1984 will differ little from their present level, which, in the case of 3-month treasury bills, is about 8½ percent. For 1985, however, credit conditions are forecast to become tighter as the economic expansion matures and the Fed pursues the kind of monetary policy already discussed in the input section of this report. The result is short-term interest rates up an average of 50 basis points for 1985 as a whole.

Finally in this overview, we note that the immediate benefits of a relatively non-inflationary economic expansion will accrue both to consumers and businesses during the next two years. Consumer purchasing power is forecast to rise by 3.7 percent and 3 percent in 1984 and 1985, respectively, while corporate profits experience a substantial cyclical recovery (before tax, including inventory valuation and cap-

CHART 1. Overview of RSQE Forecast for 1984-85



*Includes inventory valuation and capital consumption adjustments.

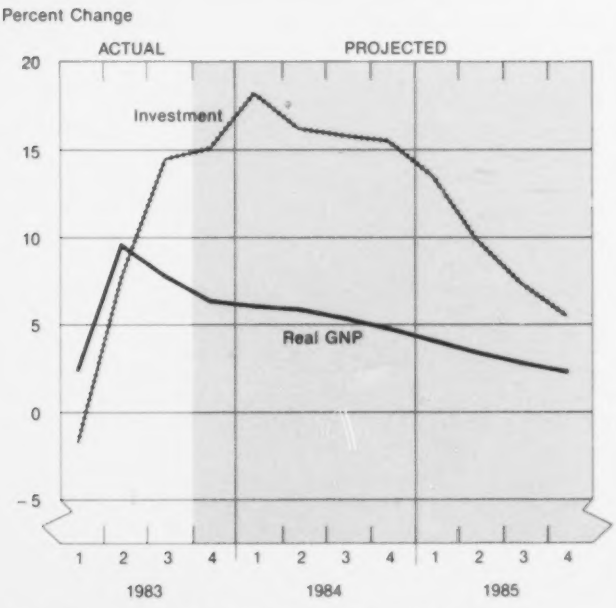
ital consumption adjustments), which is expected to carry the profit share of GNP to about 9 percent for 1985. The latter figure is comparable to the profit shares experienced in the mid-1960s and the late 1970s, and is well above the postwar low of 5.4 percent reached in 1982.

The Path of the Economic Expansion

The forecast paths of several important indicators of macroeconomic activity are described in Charts 2-5. As shown in Chart 2, our forecast implies continued economic growth for at least the next two years, but at a rate diminishing from 6½ percent in the current quarter to 6 percent in 1984:2, 4.9 percent in 1984:4, 3½ percent in 1985:2, and about 2½ percent at the end of 1985. This pattern of growth is forecast to produce a fairly smooth decline in the unemployment rate from just under 9 percent currently to about 7½ percent in the spring of 1985 (Chart 3). The GNP growth rate expected thereafter is simply insufficient to support further reductions in unemployment, and the unemployment rate remains at about 7½ percent for the balance of 1985. There are four basic factors which contribute to the existence and the extent of the slowdown in the rate of growth of the economy in 1985:

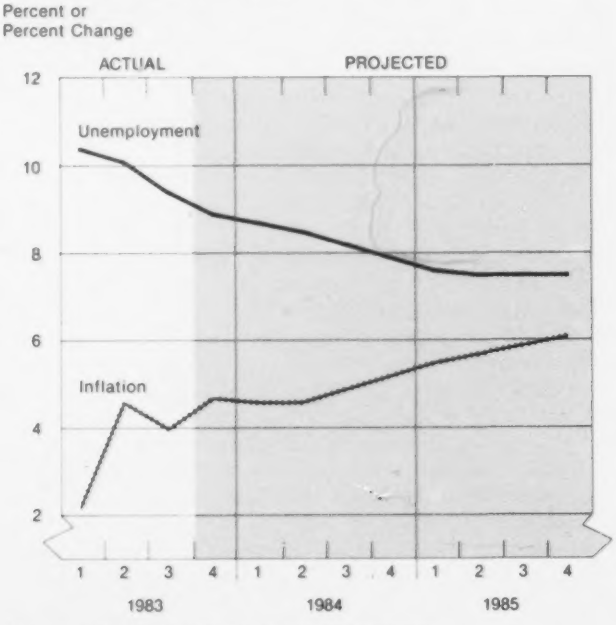
- First, of course, is the fact that 6-8 percent growth rates are so far beyond the economy's normal capacity to expand that such rates can persist only under conditions of extreme underutilizatioin of resources.
- Second, continued strength of the U.S. dollar, along with initially more rapid expansion in the U.S. than abroad, combine to favor a continual decline in real net exports, which amounts to a persistent drag on the domestic economy.
- Third, and somewhat technically, the model contains a number of so-called "accelerators" which represent a behavioral characteristic applying to certain categories of durable goods purchases such as automobiles and business equipment. Simply stated, there is a tendency for the rate of purchase of such commodities to oscillate around a sustainable average value before settling down to that value. When a number of these durable goods categories begins to accelerate nearly simultaneously in the early stages of a major cyclical recovery, sometime later many of them will be slowing down at about the same time as well.
- And finally, the monetary policy assumptions which we have made begin to bite toward the end of 1984. Interest rates are relatively high throughout the period of this forecast, but short-term rates are moving steadily upward after mid-1984 and rise by about 75 basis points from late 1984 to late 1985 (Chart 4). During that period various interest-sensitive sectors begin to feel the direct pinch of higher interest rates or the indirect effects of adverse patterns in the flow of funds. Thus,
  - automobile sales reach a peak of 10.8 million units (annual rate) in 1984:4 and then fall off slightly and steadily to a 10½ million unit rate a year later (Chart 5);
  - housing activity peaks in early 1985 and drifts down from a starts rate of nearly 1.9 million units in 1985:1 to 1.8 million units in 1985:4 (Chart 5); and
  - the rate of growth of real business capital purchases peaks at about 18 percent early next year and then declines to a rate of less than 6 percent by the end of 1985 (Chart 2).

CHART 2. Annual Rates of Growth of Real Gross National Product and Business Fixed Investment (1972 dollars)



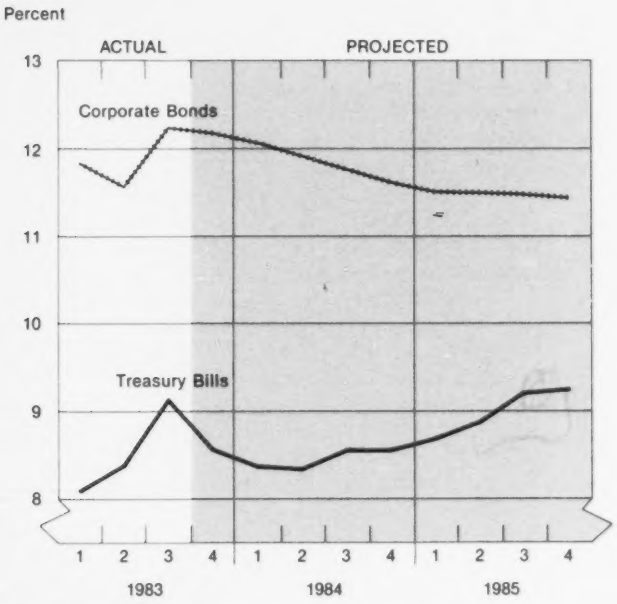
Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 3. Unemployment Rate and Annualized Inflation Rate (Personal Consumption Deflator)



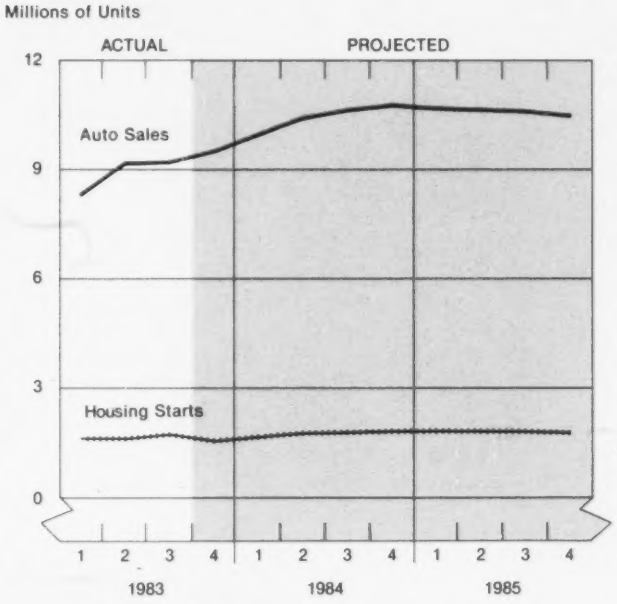
Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 4. Interest Rates for 3-Month Treasury Bills and Corporate Aaa Bonds



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

CHART 5. Automobile Sales and New Private Housing Starts



Sources: Actual data, U.S. Department of Commerce; projected data, RSQE Forecast.

Substantial additional quarterly detail from the RSQE forecast is displayed in Table 3.

Is there anything especially peculiar about the post-1982 GNP path, as it has developed to the present and as we forecast it to continue during the next two years? Part of the answer is contained in Chart 6, which plots the path of real GNP for the 12 quarters following the GNP trough quarter in the comparably severe recessions of 1957-58, 1974-75, and 1981-82. The trough dates are 1958:1, 1975:1, and 1982:4, respectively.

The first thing to note in Chart 6 is the striking similarity in the current and the post-1975 expansion paths. The transitory drop in real GNP a year and a half into the post-1958 recovery is the result of the 1959 strike in the steel industry and should therefore be disre-garded. Thus adjusted, all three of the recovery paths look extremely similar for eight quarters following the trough in real GNP, after which the post-1958 recovery path is aborted by the minor recession of 1960. The post-1975 expansion, on the other hand, continued for two years beyond the three shown in Chart 6. The simple history shown in the chart, therefore, is equally consistent with the current expansion's ending late in 1984 or continuing right through 1987. The fact that we are forecasting a GNP growth path which has considerable historical precedent may be of some comfort, but it hardly contributes to pinning down the end-point of the current expansion.

Uncertainties and Conclusions

The bottom line of this forecast is that we have good news and bad news. The good news is in Chart 2: the strong likelihood of another two years of economic expansion which should carry the economy to an unemployment rate of about 7½ percent, to the accompaniment of a fairly modest rise

CHART 6. Comparison of Economic Recoveries from Three Postwar Recessions

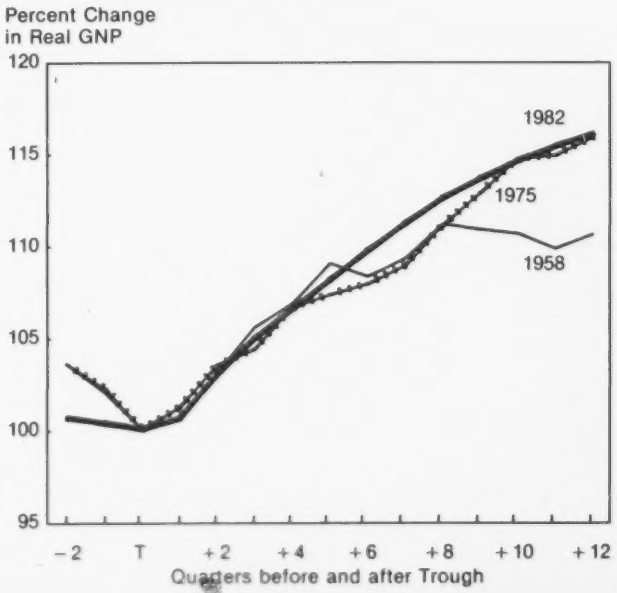


TABLE 3. Selected Economic Indicators as Forecast by RSQE

Seasonally adjusted

ECONOMIC INDICATORS	Quarterly Data										Annual Data			
	ACT.	PROJECTED									PROJECTED			
													% Changes	
	83:3	83:4	84:1	84:2	84:3	84:4	85:1	85:2	85:3	85:4	1984	1985	83-84	84-85
GROSS NATIONAL PRODUCT	3,363	3,453	3,545	3,636	3,726	3,821	3,910	3,997	4,082	4,173	3,682	4,041	11.1	9.7
PERSONAL CONSUMPTION EXPENDITURES	2,186	2,232	2,278	2,325	2,372	2,421	2,471	2,523	2,576	2,630	2,349	2,550	8.8	8.6
DURABLE GOODS	284.1	294.2	303.5	313.6	322.1	330.0	336.1	342.5	348.6	354.0	317.3	345.3	13.9	8.8
AUTOMOBILES and PARTS	137.2	144.3	150.8	158.1	163.9	169.1	172.5	176.2	179.7	182.5	160.5	177.7	20.3	10.7
FURNITURE and H.H. EQUIPMENT	102.7	104.7	106.8	108.7	110.5	112.3	114.1	115.9	117.5	119.0	109.6	116.6	8.1	6.4
OTHER DURABLES	44.2	45.1	45.9	46.8	47.6	48.5	49.5	50.5	51.4	52.5	47.2	60.0	7.7	8.0
NONDURABLE GOODS	819.0	835.6	850.9	865.3	880.5	897.1	914.8	933.1	951.6	971.1	873.5	942.6	8.1	7.9
SERVICES	1,083	1,102	1,124	1,146	1,169	1,194	1,220	1,247	1,275	1,305	1,158	1,262	7.9	9.0
GROSS PRIVATE DOMESTIC INVESTMENT	500.9	539.8	574.6	607.3	637.1	665.9	691.7	712.9	730.4	744.6	621.2	719.9	31.1	15.9
NONRESIDENTIAL	348.4	362.6	380.3	397.7	416.1	435.4	454.4	471.0	486.2	500.1	407.4	477.9	18.1	17.3
RESIDENTIAL STRUCTURES	140.7	148.1	155.2	162.5	169.0	174.2	178.4	182.1	184.9	186.8	165.2	183.1	25.1	10.8
CHANGE in BUSINESS INVENTORIES	11.8	29.1	39.1	47.1	52.0	56.3	58.9	59.8	59.3	57.7	48.6	58.9	–	–
NET EXPORTS	-25.7	-36.9	-46.8	-53.6	-57.9	-62.5	-67.0	-71.0	-74.1	-75.8	-55.2	-72.0	–	–
EXPORTS	339.3	345.3	351.3	357.7	364.9	372.8	381.3	390.3	399.7	409.8	361.7	395.3	8.1	9.3
IMPORTS	365.0	382.2	398.0	411.3	422.8	435.3	448.3	461.3	473.8	485.6	416.9	467.2	19.7	12.1
GOVERNMENT PURCHASES	701.8	718.7	739.2	757.1	775.3	796.7	814.3	832.2	850.6	873.9	767.1	842.8	10.3	9.9
FEDERAL	281.2	288.0	298.1	305.3	312.6	322.9	329.1	335.3	341.7	352.7	309.7	339.7	11.0	9.7
NATIONAL DEFENSE	205.8	211.3	219.1	225.0	231.0	238.4	243.1	247.8	252.7	260.7	228.4	251.1	12.6	9.9
OTHER	75.4	76.7	79.0	80.3	81.6	84.5	86.0	87.5	89.0	92.0	81.3	88.6	6.5	8.9
STATE and LOCAL	420.6	430.7	441.1	451.8	462.7	473.8	485.2	496.9	508.9	521.2	457.3	503.1	9.9	10.0
GROSS NATIONAL PRODUCT DEFLATOR, 1972 = 100	216.4	218.7	221.2	223.5	226.1	229.0	232.0	235.1	238.5	242.3	224.9	237.0	4.3	5.3
REAL GROSS NATIONAL PRODUCT (billions of 1972 dollars)	1,554	1,579	1,603	1,626	1,648	1,668	1,685	1,700	1,712	1,722	1,636	1,705	6.5	4.2
AGGREGATE UNEMPLOYMENT RATE (percent)	9.43	8.90	8.71	8.51	8.18	7.87	7.65	7.51	7.46	7.48	8.32	7.52	–	–
CORPORATE PROFITS plus IVA and CCA	254.6	273.4	290.4	312.9	331.0	346.2	358.0	364.4	373.6	378.9	320.1	368.7	38.0	15.2
90-DAY TREASURY BILL RATE (%)	9.14	8.58	8.39	8.36	8.57	8.57	8.70	8.89	9.22	9.26	8.47	9.02	–	–
REAL DISPOSABLE INCOME (billions of 1972 dollars)	1,101	1,111	1,119	1,128	1,136	1,146	1,155	1,164	1,170	1,117	1,132	1,166	3.7	3.0
PERSONAL SAVING RATE (percent of disposable income)	4.70	4.70	4.56	4.47	4.39	4.45	4.56	4.61	4.52	4.59	4.47	4.57	–	–

Note: All data are in billions of current dollars unless otherwise indicated.

Sources: Projections by Research Seminar in Quantitative Economics, University of Michigan; actual data from Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

in inflation from the current rate of about 4 percent up to the range of 5½-6 percent two years hence. Along the way, the automobile market is seen to enjoy a 2-year average sales rate of about 10½ million cars—compared with 9.1 million this year, 8 million in 1982, and 8½ million the year before that. Housing starts are expected to average about 1.8 million starts in the next two years, compared with 1.7 million this year and 1.1 million in each of the two preceding years. Over the next two years—measured from 1983:4—consumer purchasing power is expected to grow at a 3 percent annual rate, productivity will have risen at an average annual rate of 2 percent, capacity utilization will be up to 87 percent, and the profit share in GNP will be up to about 9 percent. This is a lot of good news indeed, and it bears little resemblance to the economy of 1981-82.

But there is a disquieting side to all of this as well. There are some elements in the scenario which are uncomfortably reminiscent of conditions which existed—and in some cases, were created—in 1981-82. And there is a concern about whether our forecast is indicating that the expansion will have petered out by the end of 1985. If so, we will have gotten the civilian unemployment rate barely back to where it was when the recession hit in 1981, and only very briefly; and that hardly seems like real progress.

There are even more fundamental issues than whether GNP will turn down in late 1985 or early 1986. After all, many events—policy and otherwise—which we can hardly discern now will occur during the next two years, and some of these could easily reshape the 1985-86 outlook dramatically.

BEST AVAILABLE COPY

We should, of course, take seriously the message that currently perceived conditions imply the strong likelihood of a significantly reduced economic growth rate by mid-1985. That implies the need to watch events very closely and to make considered judgments about the proper course of macroeconomic policy. And it raises most directly the fundamental issues that must be addressed. There is nothing in our forecast scenario which takes care of the high interest rates which continue as a nagging part of the environment. Do we want the distribution of economic activity implied by a high interest rate environment? There is nothing in the scenario which involves solution to or a real amelioration of international financial strains—and that remains a continuing source of uncertainty plaguing the domestic monetary system and the domestic economy in general.

There is no automatic solution to the budget deficit problem in our forecast. The economic growth of the next two years reduces the budget deficit by a total of some $30 billion, and that is roughly comparable to what happened two or three years after the 1974-75 recession. But by that time we were dealing with a deficit of about one percent of GNP, not the 4 percent we are forecasting for 1985. And the situation could easily deteriorate after 1985 because of the increasingly large revenue losses caused by indexation of the personal tax system. If it's not feasible to put federal spending on a severely reduced growth path, the deficit problem—under current tax laws—may well be permanently with us. That has grave implications for the composition of economic benefits, the flexibility of monetary policy, and economic stability in general. It is not irrelevant that the present administration has engineered a fundamental imbalance in the federal budget. The money markets look ahead, and capital investment decisions are made on the basis of long-term expectations. We are ill-advised to support or continue with a set of economic policy decisions which have undesirable long-term consequences. Despite the shiboleths regarding what constitutes political wisdom in an election year, we can hardly afford to wait long before turning seriously to measures which will correct the fundamental imbalance in the structure of federal taxing and spending.

November 1983

Editor's Note: A Michigan Model forecast produced early in February was broadly consistent with the November forecast discussed above.

The Economic Outlook and Economic Policy*

Gardner Ackley
Henry Carter Adams University Professor of Political Economy
The University of Michigan

My perhaps parochial view is that the forecasts made by my University of Michigan colleagues—headed by Saul Hymans and doing business as the University of Michigan's Research Seminar in Quantitative Economics (RSQE)—are a good deal better than the average macroforecast. Indeed, their forecast a year ago hit the 1983 recovery just about on the nose. Their latest predictions and policy analyses were released in November at the 31st annual University of Michigan Conference on the Economic Outlook and are summarized elsewhere in this issue.

This forecast calls for growth in real GNP at a rate of 5.6% between the fourth quarters of 1983 and 1984, slowing to 3.2% real growth over the four quarters ending in 1985:4. It assumes that there will be no change in federal tax laws and that federal expenditures in the national income and product accounts (NIPA) will rise about 7% in fiscal 1984 and a further 8% in fiscal 1985, thereby producing NIPA deficits of $171 billion and $156 billion respectively in the two years. These budgetary forecasts are considerably more optimistic than most—undoubtedly reflecting some combination of higher real growth and lower interest rates than are implicit in most other forecasts. Even so, I think they are too low.

Federal Reserve policy is assumed by the RSQE forecasters to allow the monetary base to grow by 5% during both 1984 and 1985, and to hold the discount rate unchanged. On the basis of these fiscal and monetary policy assumptions, the resulting economic forecast produces a treasury bill rate that dips a bit early in 1984 but returns to 8.6% by the fourth quarter; it then rises to about 9¼% by the fourth quarter of 1985. The corporate Aaa interest rate is forecast to fall slowly but to remain close to 11½% during 1985.

Now, if we compare the RSQE forecasts of corporate Aaa interest rates for the fourth quarters of 1984 and 1985 with its forecasts of the GNP deflator, we derive implied forecasts of one version—even if not conceptually ideal—of a *real* corporate Aaa rate of about 7% in late 1984 and about 5% in late 1985. These are extremely high real interest rates! Defined in exactly the same way, real Aaa corporate rates averaged only 2.6% during the 1960s and only 1.9% during the 1970s.

To be sure, the similarly defined real Aaa rate in the third quarter of 1983 was about 8%, without preventing recovery in investment and GNP. Nevertheless, given these implied forecasts of remarkably high *real* interest rates continuing to face investors, I find it a bit surprising that real nonresidential fixed investment can be forecast in the Michigan Model to rise as much as 16.5% between the fourth quarters of 1983 and 1984, and another 9.1% during 1985.

*Adapted from comments prepared for a symposium at the annual meeting of the American Economic Association, San Fransisco, California, December 28, 1983.

That real business investment rises at all may, of course, be explained by accumulated technological innovation, by accelerator effects, and by swelling corporate profits, which are predicted to rise 60% over the next four quarters. On the other hand, real residential construction, forecast to rise 10.4% during 1984, is not expected to increase at all during 1985.

Crowding Out

These forecasts of rapidly declining gains in business and residential investment appear to involve "crowding out" with a vengeance. This, of course, is what a great many forecasters seem to be predicting, if something is not done about the huge federal deficits that are expected to continue. The common but least sophistacted version of the crowding-out story runs something like this. Financing massive federal deficits adds to the *total market demand for loans.* This increase in the demand for loans must raise interest rates (unless expansionary monetary policy prevents it). Soon, interest rates will rise sufficiently to choke off enough private investment so as to stabilize interest rates—but at levels of interest rates *far too high* for full employment, while producing levels of investment that provide far too little growth of potential output.

However, this common but unsophisticated version of crowding out is clearly unsatisfactory. For with the economy well below full employment, massive federal deficits involve a large and growing *public demand* for goods and services which is *not* offset by tax levies that more or less equivalently reduce the *private demand* for goods and services. The resulting higher level of total demand will increase GNP and personal and corporate income, thereby both raising private saving and reducing the federal deficits. The enlarged private saving can thus finance the remaining deficits. In short, so long as output can expand freely, no crowding out becomes necessary, in the sense of a demand for loans in excess of the supply of loans at the initial interest rate. To be sure, if the supply of money is unchanged and the demand for money rises to reflect increased transactions (as well as increased wealth), then interest rates will rise somewhat. However, monetary policy can accommodate such an increased demand for money with an increased supply, without necessarily having inflationary effects, other than those effects (if any) that are associated with an increased aggregate demand from any other source, such as increased *exports* or *private* investment. "True" crowding out should occur only at "high" or "full" employment.

In this preferred version of the story, we need not worry about crowding out until we are a lot closer to high employment than is forecast for the end of 1985. Of course, as we *approach* high employment—if we do—inflation might begin to reaccelerate. If so, we might well need to reduce federal deficits for *that* reason. But we need not act now. Indeed, for the near term it seems quite possible that large federal deficits, financed by selling bonds and bills, might even produce some "crowding *in*" of private investment—à la Benjamin Friedman's wealth and portfolio effects.

Why Worry about Deficits?

What, then, *is* the basis for worry about deficits? First of all, I see *no* reason to worry about the deficits now, nor during 1984. Rather, we should welcome them for their contribution to recovery. But I do worry about deficits of the size currently forecast if they should extend much beyond 1984. Why? *Not* because the financing of them would require the crowding out of investment as we bumped into a ceiling on output. But simply because, with fuller recovery from recession—say in 1985—the level of public plus private aggregate demand accompanying the large deficits may begin to push unemployment below the "NAIRU"—the non-accelerating-inflation rate of unemployment. Unless curbed by tighter monetary or fiscal policy, this would threaten a reacceleration of inflation. If demand is then curbed by monetary policy, as now seems likely (by default) to be the policy choice, it would generate even higher interest rates—and thus would come at the expense of investment and growth. In my view, this result can and should be avoided by phasing in higher tax rates—probably effective in 1985. We will surely need to do this if all of the massive defense-spending increases now planned are really unavoidable.

Like Martin Feldstein—and maybe even (who knows?) Ronald Reagan—I urge that such a tax increase be legislated in 1984, to become effective sometime in 1985. My personal preference in raising taxes would be first to eliminate tax indexation, to continue with the repeal of as much of the excessive corporate tax give-aways enacted in 1981 as can be achieved, and to conclude with the take-back of whatever part is necessary of the personal income tax cuts. I would not object to a shift to a well-considered and *clearly progressive* consumption tax; but under no circumstances should we enact federal excise or value-added taxes, which are, among other things, regressive and which, because they enter directly into prices, would immediately reignite inflation.

Monetary Policy

I see no need for monetary policy to tighten if fiscal policy is properly adjusted. It may seem unrealistic to assume that taxes can be raised in an election year. However, I once helped to get taxes raised in an election year, which may or may not have contributed to my party's candidate's losing that election. But, if tax increases are not enacted, and recovery proceeds apace, there will be severe pressures on the Fed to tighten as recovery proceeds in 1984 and 1985. In that event, I see little hope that recovery could remain robust or long continue.

It seems obvious to me that—for domestic political and social reasons, as well as to avoid potentially very serious international economic, social, and political problems—we need, and the world needs, a strong, healthy, and prolonged U.S. economic recovery and expansion. This will require judicious, flexible, and timely stabilization policy adjustments. Unfortunately, I very much doubt that either the present administration, the present ideological and social climate in America, or even the present tendencies in the economics profession are ready to initiate or to support such flexible policy adjustments.

In short, I am pessimistic about the current state of U.S. economic policy and about the prospects for constructive solutions to our problems. I fear that we are heading toward increased instability, further inappropriate microeconomic interventions in the name of macroeconomic health, reduced international cooperation, and more beggar-thy-neighbor competition in constraints on trade and payments.

It is not the best of times either for economics or for the economy.

The Return of Sustained Expansion?

Paul W. McCracken
Edmund Ezra Day University Professor of Business Administration
The University of Michigan

These are not easy times for economists who only feel comfortable when taking a pessimistic view about business prospects. And while the profession has never been the "dismal" lot that the poet Thomas Carlyle suggested in his famous dictum, there have been enough reasons to be concerned about the malfunctioning of the economy, and for long enough, so that optimism almost has the discomforts of a new pair of shoes. For uncomfortably close to a couple of decades, a dour interlude of history beginning about the mid-sixties, the American economy has exhibited varying degrees of sub-par operating characteristics. We had almost forgotten that historically the U.S. economy has operated with inflation at an average rate of 2 percent per year, an average unemployment rate of about 5 percent, and gains in real income and productivity of 2-2½ percent per year.

If performance is the measure of policy, the prize for the best strategy for economic policy in this century would probably have to be awarded to, surprising as it may seem, Calvin Coolidge. From 1922 to 1929 the unemployment rate averaged 3.7 percent, the consumer price index rose 0.3 percent per year, real income per person rose at the average annual rate of 3.1 percent, and—contemporary Republicans take notice—he reduced the national debt 26 percent.

Recent Cost-Price Improvement

While we are not yet ready to measure up to Silent Cal's awesome standards of economic performance, 1984 does inherit an impressive legacy from its predecessors. Indeed, two sets of evidence about our economic prospects argue persuasively for a quite optimistic view of the economic outlook. For one thing, the cost-price level has been displaying a remarkable degree of stability, relative to our history since the mid-1960s, even though production and employment have been rising strongly. This is a development of major significance. One of the exasperations of the 15 years from the mid-1960s to the end of the last decade was the relentless tendency for costs per unit of output to rise. During the 1970s annual increases in compensation per man hour rose persistently except for 1975 and 1976, and reached the double digit zone by 1980. If that rising trend had continued, increases in compensation per hour would have been in the 12 percent zone last year. The increase was actually 5 percent, a rate not seen since the mid-1960s; and with strong gains in productivity the increase in labor costs per unit of output last year was about one percent.

We saw last year, therefore, a stability in the price level not out of character with our history but also not seen for so long that we had almost forgotten about the longer-run stability in the purchasing power of the dollar. Prices of finished products at the producer level rose only 0.6 percent in 1983, and prices of consumer goods excluding food actually were somewhat lower than in 1982 (again at the producer level).

The important thing at this juncture is to see this sort of price-cost stability as fundamentally characteristic of the American economy's performance, not some sort of weird quirk that can never be expected to recur. The odd-ball chapter in our history was the long excursion into instability that got underway about 1966.

Good News about Purchasing and Capital Spending

The second set of encouraging evidence about our economic prospects is what the "fore-shadowing" indicators are saying. Economic forecasting, many suspect, involves observing the entrails of a dead goose, evaluating the nature of rings around the moon, and pondering the pattern of sun spots. Indicators of the economic future are not infallible, but they are not quite this astrological. Indeed, there is logic in the assumption that some of these indicators ought to lead movements in general economic activity. And what these have been saying is good news. In January, for example, the percent of purchasing executives reporting an increase in the volume of incoming business exceeded those reporting a reduction by 34 percent. This is a large net number, and it suggests for the months ahead further good gains in production and employment. And this is evidence to be taken seriously. It would be difficult to think of a group whose finger tips are more sensitively on the pulse of business than these members of the National Association of Purchasing Management.

Before 1984 was far along the Department of Commerce brought some good news about prospective outlays for plant and equipment. This has been a concern during the current expansion. For one thing a revival of these basic capital outlays has historically been the driving force carrying on a cyclical expansion after about the first year. (During the first year the revival of consumer demand and the cessation of further inventory liquidation usually carry the load.) Moreover, the financial stringencies experienced by many companies during recent years and the low operating rates many had reached by the end of 1982 raised the possibility that these basic capital outlays this time might be slow to revive. If so the economy might be stranded after the first stage of this expansion, with little to keep it going after 1983.

For those thus worried the Department of Commerce survey was surprisingly good news. After declines last year in all major segments of businesses, companies are projecting strong increases *in real terms* for 1984—for all businesses a projected increase of 9.4 percent (Table 1). Moreover, these data (based on survey responses from the companies themselves) provided little support for the grim view that firms in the manufacturing sector are engaged in the process of the de-industrialization of America. Manufacturers are projecting a rise in these outlays in real terms of 13 percent, and those in durable goods (hardest hit by both the 1981-82 recession and problems of foreign competition resulting from the over-valued dollar) are projecting a 16 percent rise. Such figures do not suggest that these firms see themselves evacuating their markets.

TABLE 1. Increase In Expenditures for New Plant and Equipment (In constant dollars; nonfarm businesses)

Type of Business	1982-83	1983-84
Manufacturing	−5.6%	13.0%
Durable goods	−7.8	15.9
Nondurable goods	−3.3	10.0
Nonmanufacturing	−2.3	7.4
Weighted Average	−3.5	9.4

Source: U.S. Department of Commerce.

Auto companies are projecting particularly large increases in their outlays to enlarge and renovate their production facilities. Indeed, theirs is the largest projected increase (34 percent in current dollars) of the major industrial lines, with companies making electrical machinery and fabricated metals also projecting strong gains. This is not a picture of going out of business—of de-industrialization.

Threats to Continued Expansion

After the euphoria of last year with its unexpectedly strong gains, and with the indicators pointing to strong further improvement in 1984, we must expect some nervous second thoughts to be coming along about prospects for the year ahead. Is this another case of where almost massively good news is blinding us to the fall that lies just ahead? The economy has, of course, been tackled from its blind side before, and it is not amiss for us to direct an occasional anxious glance behind us. The major threat to sustained economic expansion, as is almost always the case, is posed by economic policies themselves. One is the hemorrhaging U.S. external trade position, which gave us an overall trade deficit approaching $60 billion last year, and a particularly sharp swing from surplus to deficit in our trade in manufactured goods (Table 2). This in turn is primarily, though not entirely, the result of our large budget deficits that create foreign demand for dollars to take advantage of high interest rates here.

TABLE 2. U.S. Trade Surplus In Manufacturing Goods and the Index of the Dollar's Real Effective Exchange Rate (Dollar amounts in billions)

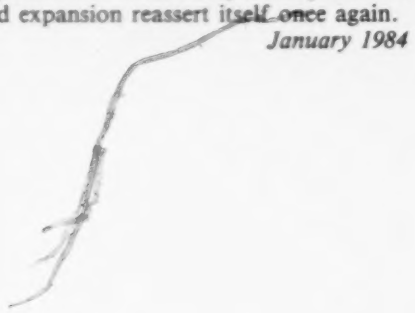
Year	Trade Surplus	Exchange Rate Index*
1979	$ 4.4	88.0
1980	18.8	89.5
1981	11.8	100.7
1982	−4.3	109.8
1983	−10.0	112.0

*1980-82 = 100.

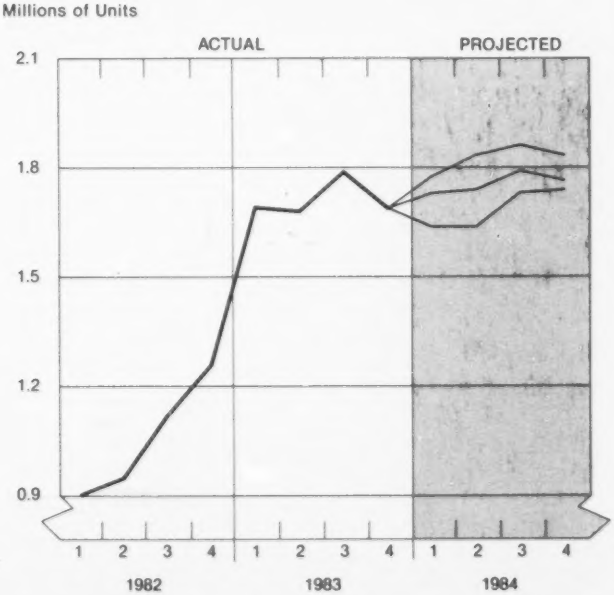
Source: Trade data—Department of Commerce; Index of the dollar's real effective exchange rate—*World Financial Markets*, December 1983, p. 10.

We can live with these pressures through 1984, though with the probability of growing discomfort by year end. If by the forepart of 1985 the present political impasse can be resolved, the 1980s could see the inherent capability of the U.S. economy to operate with a reasonably stable price level and more sustained expansion reassert itself once again.

January 1984



NEW PRIVATE HOUSING UNITS STARTED



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Optimism Rides High Plateau

Richard T. Curtin
Director, Surveys of Consumer Attitudes
Survey Research Center
The University of Michigan

Optimism Maintained at Record Levels

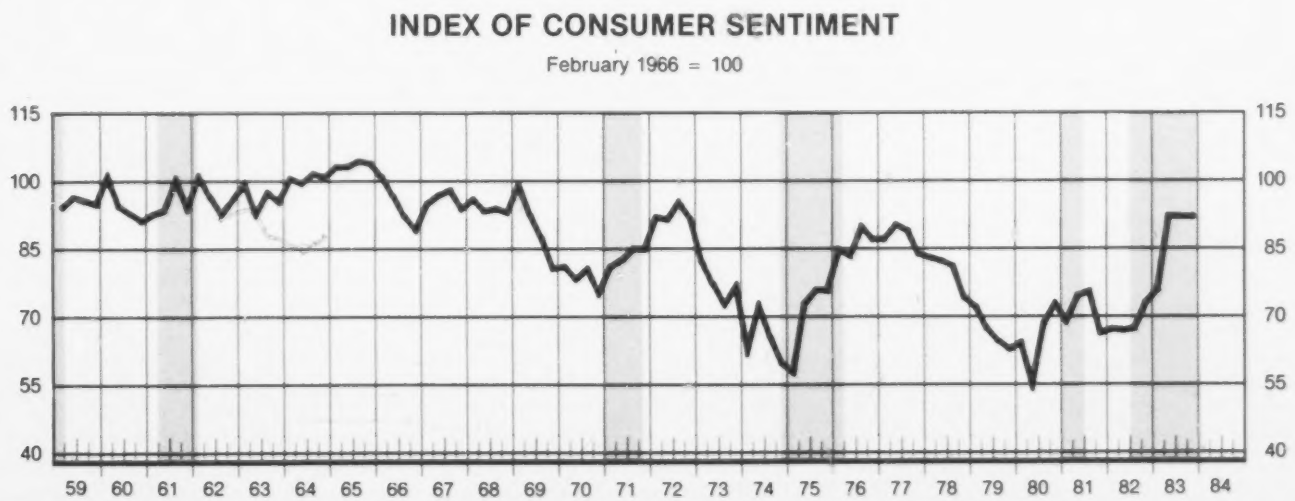
In the fourth quarter 1983 survey, the Index of Consumer Sentiment was 91.5, nearly identical to the 91.6 recorded in the third quarter of 1983 and the 91.5 recorded in the second quarter of 1983. Consumer optimism and confidence have not been as favorable for as long since 1972. The recent substantial improvement in consumer sentiment has broken the pattern of increasingly lower cyclical peaks that had been recorded since the all-time record level was set in 1965 (see the chart below). The recovery in consumer sentiment has been wide-ranging, covering attitudes toward personal finances, business, and market conditions; and the recovery in sentiment has been broadly based, occurring across all regions of the country and across all age and income subgroups. Although the overall level of consumer sentiment has remained unchanged during the past nine months, small offsetting trends have been recorded. Favorable expectations for future improvement paced the initial rise in optimism in early 1983 but have since receded slightly from their mid-year peak levels. Favorable evaluations of current economic conditions rose rapidly as the recovery period lengthened and reached peak levels in late 1983. This reflects a slowing in the expected pace of improvement in the economy as the recovery period lengthens. Overall, these small declines from peak levels do not detract from the otherwise very favorable levels of consumer attitudes and expectations.

Personal Finances Strengthen

The personal financial situation of American families improved substantially during 1983, and at year end the proportion of families that reported favorable changes in their financial situation was the highest recorded since the 1972 peak. The fourth quarter 1983 survey marked the third consecutive quarter in which more families reported an improved rather than a worsened financial situation. This was in sharp contrast to the prior four years, when unfavorable evaluations of personal finances predominated. Among all families, 40 percent reported in the fourth quarter survey that their financial situation had improved, up from 31 percent one year earlier. In contrast, 27 percent of all families reported that their financial situation had worsened, down from 41 percent one year earlier.

The improvement in personal finances during the past year has been due to more favorable income and inflation trends. In the fourth quarter 1983 survey, 31 percent of all families reported increases in family income (up from 29 percent one year earlier), while 16 percent of all families reported income declines (down from 22 percent one year earlier). References to the unfavorable impact of inflation on family budgets were made by 17 percent in the fourth quarter 1983 survey, compared to 16 percent one quarter earlier (the lowest level recorded in a decade) and 25 percent one year earlier. Consumer complaints about inflation have declined substantially from four years earlier, when unfavorable references to inflation were made by 46 percent of all families. Combined, these improvements in family incomes and declines in inflation have led to the most favorable evaluations of real income progress recorded during the past decade. The majority of American families reported in the fourth quarter survey that increases in their family income had kept pace with or exceeded the rate of inflation during 1983.

By a wide margin, the 1983 fourth quarter survey showed that American families expected further improvements in their financial situation during the year ahead. Among all families, 37 percent expected their financial situation to improve during 1984, while just 11 percent expected a worsening financial situation. Compared with a year earlier, the 1983 fourth quarter survey recorded only a small increase



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

in the number of families that expected improvement in their financial sitation (37 percent, up from 35 percent), but fewer families expected financial reversals in the year ahead (11 percent, down from 16 percent). In explaining their prospects, fewer families in the fourth quarter survey expected their nominal income to decline during the year ahead than expected declines one year earlier (12 percent, down from 15 percent). The proportion of families in the fourth quarter survey that expected their income to increase during the year ahead was just above the year earlier reading (60 percent, up from 58 percent), but, overall, families expected smaller income increases: the proportion of families that expected increases of 10% or more fell from 28 to 23 percent, while families that expected income increases of 1-4% rose from 6 to 12 percent. The overall median income increase expected by families during 1984 was 3.9%, down from the 4.7% recorded one year earlier.

Recession: Over But Not Forgotten

The fourth quarter survey recorded the most favorable perceptions held by American consumers of recent improvements in the economy during the past 30 years. Among all families, 67 percent reported in the fourth quarter 1983 survey that the economy had improved during the past year, up from 63 percent in the third quarter and just 14 percent in the fourth quarter of 1982. Only 10 percent of all families in the fourth quarter 1983 survey expected the economy to worsen during 1984, while 45 percent expected continued improvement. Sixty-two percent of all families in the fourth quarter 1983 survey expected these improvements to lead to good times financially in the economy as a whole during 1984. This was virtually unchanged from the 60 percent recorded in the third quarter and the 61 percent recorded in the second quarter 1983 surveys.

Consumers have become more optimistic about the short-term outlook for the economy because of favorable trends in employment and inflation, as well as greater confidence in government economic policies. Thirty-five percent of all families in the fourth quarter 1983 survey expected unemployment to decline during 1984, nearly twice the 18 percent that expected unemployment to increase. An annual rate of inflation of 5.1% was expected in the fourth quarter 1983 survey, just below the 5.6% recorded one year earlier. While the overall mean expected inflation rate has remained largely unchanged during the past year, fewer consumers reported in the fourth quarter 1983 survey that they expected prices to remain unchanged or to decline (24 percent, down from 32 percent one year earlier). Among those families that expected price increases, the proportion that expected an inflation rate of 10% or more fell to 17 percent from 22 percent one year earlier, while the proportion that expected inflation rates in the 1-5% range rose to 43 percent from 30 percent. Confidence in government economic policies to combat inflation and unemployment improved substantially during 1983 and at year-end nearly gained the levels recorded when President Reagan entered office. Among all families, 27 percent favorably rated government economic policies in the fourth quarter 1983 survey, up from 20 percent one year earlier. Unfavorable ratings of government economic policies fell to 21 percent in the fourth quarter, from 32 percent one year earlier.

Longer-term prospects for the economy as a whole improved to favorable levels in early 1983 but since then have remained largely unchanged. During the last three quarters of 1983, the proportion of families that expected good times financially over the next five years remained in a narrow range of 38 to 39 percent. Unfavorable long term business expectations were reported by approximately the same proportion of families—38 to 40 percent. In the fourth quarter survey, the balance of opinion was unfavorable, with 39 percent expecting good times financially and 40 percent expecting bad times in the economy as a whole over the longer term. To be sure, these evaluations are greatly improved over the recession lowpoint and now stand nearly equal to the last cyclical peak recorded during the late 1970s. Compared with prior cyclical peaks, at least as many families reported favorable long-term business expectations (the 39 percent recorded in 1983 was the highest since 1969), but families more frequently expected unfavorable long-term developments (40 percent in 1983, compared with a low of 25 percent recorded in the 1970s). These results indicate that consumers are still unconvinced that the short-term improvements will lead to a long-lasting recovery. The repeated cycles of recession and recovery during the past decade have not been forgotten, even in the current mood of optimism.

Interest Rate Concerns

At this time, unfavorable interest rate expectations represent the primary factor associated with diminished prospects for a long lasting recovery. Interest rates were expected to increase during the year ahead by 37 percent of all families in the fourth quarter 1983 survey, somewhat below the 44 percent recorded in the third quarter but well above the 22 percent recorded one year earlier. Interest rate declines were expected by 22 percent of all families in the fourth quarter of 1983, just above the 19 percent recorded one quarter earlier but well below the 46 percent one year earlier.

Favorable Buying Attitudes

Attitudes about buying conditions for cars, houses, and large household durables all remained at very favorable levels in the fourth quarter 1983 survey. The majority of all families continued to rate buying conditions favorably in each market studied, although the proportions holding favorable attitudes have declined somewhat since mid-year.

Favorable buying attitudes toward large household durables were held by 63 percent of all families in the fourth quarter 1983 survey, just below the peak of 65 percent recorded one quarter earlier and well above the year-earlier reading of 48 percent. When asked to explain their views, 35 percent of all families in the fourth quarter 1983 survey mentioned the availability of lower prices and discounts on household durables, up from 30 percent one year earlier. The widespread appeal of lower prices and discounts on household durables has dominated consumer views about buying these household items to a greater extent during 1983 than at any other time during the prior 20 years.

The proportion of families holding favorable attitudes toward buying conditions for houses was 55 percent in the fourth quarter 1983 survey, down from the second quarter peak of 64 percent. The small decline since the second quarter has been due largely to fewer references to reduced mortgage interest rates—falling to 40 percent at year end from 57 percent in the second quarter. Complaints about high mortgage rates, in contrast, only rose to 28 percent by year end from the second quarter low of 23 percent. Perceptions of housing prices also remained on balance favorable in the

fourth quarter survey, although by a narrower margin than earlier in 1983. References to the availability of lower housing prices fell to 19 percent in the fourth quarter of 1983 from the second quarter peak of 23 percent, while complaints about high housing prices only rose to 15 percent from the second quarter low of 13 percent.

Favorable car-buying attitudes were held by 58 percent of all families in the fourth quarter 1983 survey, down from the record peak of 65 percent in the second quarter 1983 survey. Although favorable car-buying attitudes have declined somewhat since mid-1983, in the fourth quarter 1983 survey they were still as favorable as they were at peak levels during the 1970s. Specific vehicle purchase intentions have increased substantially during the past year. Among all families, 17 percent reported in the fourth quarter 1983 survey that they expected to purchase a new vehicle during the next 12 months, an all-time record.

Fewer respondents have mentioned the availability of lower interest rates on car loans since mid-1983, falling from 40 to 20 percent by year end. Only a small increase in complaints about high interest rates was recorded, rising from a second quarter low of 8 percent to 9 percent by year end. Perceptions of vehicle prices also became somewhat less favorable. In the third quarter of 1983, the proportion of families mentioning high vehicle prices fell to a low of 18 percent (down from 30 percent in the third quarter 1982 survey). Accompanying the new model introductions, the proportion mentioning high prices rose to 24 percent by the fourth quarter of 1983 (just below the 25 percent recorded in the fourth quarter of 1982). At the same time, references to the availability of lower prices and rebates declined to 21 percent in the fourth quarter of 1983, from 31 percent one year earlier. As a result, for the first time in 1983, an unfavorable balance of opinion towards vehicle prices was recorded in the fourth quarter survey.

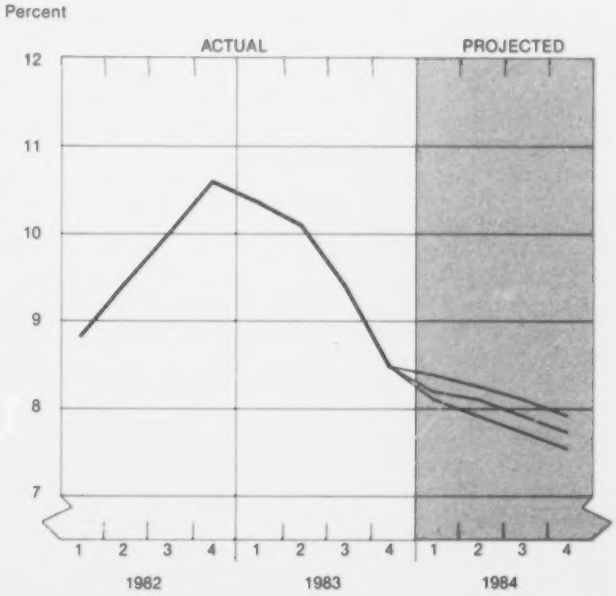
Summary Outlook

The recent overall trends in consumer attitudes and expectations can be summarized rather easily: consumer sentiment is now more favorable than at any other time during the prior decade. Following a rapid improvement in early 1983, a broad range of consumer attitudes and expectations have receded slightly from a mid-year peak. This reflects a slowing in the expected pace of improvement in the economy as the recovery period lengthens. Overall, these small declines from peak levels do not detract from the otherwise very favorable levels of consumer attitudes and expectations. The majority of consumers now expect improvement in their own financial situation as well as for the economy as a whole during the next year or so, but the majority do not expect these good times to persist uninterrupted into the longer term. Nonetheless, the rapid improvement in consumer optimism earlier in the year together with its subsequent maintenance at favorable levels point toward continued increases in sales of vehicles, houses, and large household durables in 1984.

The distinctive aspect of this recovery is that expected trends in inflation, coupled with more volatile and higher interest rate expectations, have begun to restructure consumer attitudes toward market buying conditions. During the 1970s, consumers found the most important source of variability in buying conditions to be changes in product prices, and they frequently adopted buy-in-advance rationales in response to expected price increases. This response predominated at that time because interest rates charged on consumer loans were largely unresponsive to changes in the expected rate of inflation. The "buy-in-advance psychology" which developed represented a significant restructuring of buing attitudes from the 1950s and early 1960s. Since 1980, consumers have viewed interest rates charged on consumer loans, rather than inflation, to be the most important source of expected variability in market buying conditions. This new "interest rate psychology" will determine the length and pace of the current recovery in consumer sales.

January 1984

UNEMPLOYMENT RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Results from the November NABE Survey

Richard E. Barfield
Survey Research Center
The University of Michigan

The seventh in the series of quarterly surveys of National Association of Business Economists (NABE) members was conducted this past November. Respondents were asked to forecast various economic series and to give their opinions about current economic policy matters.

Conditions in Company/Industry

Throughout the survey program, economists affiliated with a business firm have been asked about quarterly trends in various economic aspects of their own company or industry. Results from the November survey are displayed in Table 1 and seem generally consistent with the moderately vigorous economic expansion experienced during the three months preceding the survey:

- Demand was up in a substantial majority of the companies, and employment had been rising or stable for all but 15 percent.
- Inventories had been increasing in only about a third of the firms.
- Real capital outlays had been rising in about a third of the companies and falling in only about 10 percent.
- Profit margins had been going up in over half the firms, while prices had on the whole remained pretty stable during the period.
- Wages and salaries had been rising in slightly fewer than half of the firms and stable in slightly more than half, with virtually none reporting falling compensation.

As mentioned in previous reports, NABE respondents are classified according to their primary affiliation in six groups: manufacturing, nonbank finance, trade associations and others not elsewhere classifiable, government and academic, commercial banking, and consulting. Ordinarily, then, we would be able to discuss differences in the reports of respondents associated with different industries. However, the response rate for the November survey was lower than usual, producing fewer observations than desirable for the separate affiliation groups, and we will limit this discussion to the aggregate results. Most of the November responses about company and industry conditions came from economists affiliated with manufacturing and commercial banking.

TABLE 1. Trend in Various Economic Aspects of Respondent's Company or Industry During Three Months Prior to Interview

Economic Aspect	Rising	Same	Falling
Unit Volume of Demand	70%	28%	2%
Employment	36	49	15
Unit Volume of Inventories	35	42	23
Real Capital Outlays	33	56	11
Profit Margins	54	27	19
Prices Charged	20	69	11
Wage Rates & Salaries	44	52	3

Economic Forecasts

Table 2 displays the median values of forecasts made in November for selected economic series. Real GNP was expected to increase by slightly less than 5 percent from 1983:4 to 1984:4 (up a bit from the 4.6 percent forecast in the August 1983 survey) and by just above 5 percent for the full year 1984 as compared with 1983. Consumer prices were foreseen to increase by just about 5 percent fourth quarter to fourth quarter (the same as in August) and by the same amount year over year. Real fixed investment was forecast to increase by about 9 percent from 1983:4 to 1984:4 (up sharply from the 4.9 percent August estimate) and by slightly over 9 percent for all of 1984 compared with 1983.

The business economists predicted that the unemployment rate would average just about 9 percent for the fourth quarter of last year (down slightly from the 9.2 percent forecast in August), just about 8 percent in the fourth quarter of 1984, and about 8.3 percent for the year 1984. Given the dramatic unemployment rate declines in November and December, the NABE forecasters were obviously off the

TABLE 2. Forecasts of Selected Economic Series, November 1983

Series	Median Value
Annualized Percent Change:	
Real GNP	
1983:4-1984:4	4.88
Year 1983-Year 1984	5.05
Consumer Price Index	
1983:4-1984:4	5.05
Year 1983-Year 1984	5.02
Real Fixed Investment	
1983:4-1984:4	8.94
Year 1983-Year 1984	9.13
Percent:	
Unemployment Rate	
1983:4	8.96
1984:4	8.09
Year 1984	8.29
Prime Rate	
12/31/83	11.02
6/30/84	10.86
12/31/84	11.20
Millions of Units:	
New Private Housing Starts	
1983:4	1.66
1984:4	1.74
Year 1984	1.73
Automobile Sales	
1983:4	9.88
1984:4	10.31
Year 1984	10.04

mark for 1983:4 and will probably be somewhat high for this year as well. The prime rate was expected to be about 11 percent at the end of 1983 and slightly below that figure at mid-1984 (both figures quite close to the August prediction); it was seen to rise a bit by the end of 1984.

New private housing starts were expected to average about 1⅔ million units in 1983:4 and 1¾ million units both in 1984:4 and for the year as a whole (the fourth quarter estimates were quite close to those given in the August survey). Auto sales were expected to reach 9.9 million units in 1983:4 and to climb farther to 10.3 million in 1984:4, averaging about 10 million units for 1984 as a whole (the fourth quarter estimates were several hundred thousand units higher than the August ones).

Two new regional forecast questions were included in the November survey. Respondents were asked whether "the overall economic growth rate in your part of the country will be faster than, slower than, or about the same as the national rate during 1984" and whether "the unemployment rate in your part of the country will be higher than, lower than, or about the same as the national rate during 1984." Rather predictably, economists in the South and West foresaw higher economic growth and lower unemployment rates during 1984 compared with the nation as a whole. And those in the slow-to-recover North Central region were most pessimistic about growth and unemployment trends: 50 percent of economists in that region anticipated lower-than-average growth rates, compared with 20 percent from the other three regions combined, while 76 percent expected higher-than-average unemployment rates, compared with only 21 percent elsewhere.

Fiscal and Monetary Policy

As in previous surveys, the business economists were asked about recent fiscal and monetary policy. Trends over the past four surveys in their assessment of the appropriateness of fiscal and monetary policy are displayed in Table 3. While there was some quarter-to-quarter fluctuation during 1983 in opinion about fiscal policy, the basic consensus that policy has been too stimulative remained pretty stable during the year, with some 70-75 percent holding that view in each survey. Less than a quarter saw fiscal policy as about right, and less than a tenth believed it too restrictive during 1983. Compared with late 1982, opinion during the past year was somewhat less polarized, with fewer seeing fiscal policy as too stimulative or too restrictive and more finding it about right.

Concerning recent monetary policy, the November survey indicated a shift in opinion. While about a quarter of the sample viewed monetary policy as too stimulative in February, May, and August last year, by November only about 3 percent said that monetary policy was too stimulative; and the proportion assessing it as too restrictive about doubled in November compared to the three earlier quarters. A new monetary policy question posed in November asked whether the U.S. and other major countries (France, the U.K., Japan, etc.) should coordinate their monetary policies "so as to reduce exchange rate fluctuations and lessen inflationary pressures." Opinion was split quite evenly, with about 45 percent favoring coordination and about 55 percent opposing it.

TABLE 3. Trends in Opinions about Fiscal and Monetary Policy, February 1983-November 1983

Opinion	February	May	August	November
Fiscal Policy:				
Too Stimulative	70%	73%	76%	73%
About Right	23	21	20	22
Too Restrictive	8	7	4	5
Monetary Policy:				
Too Stimulative	27%	26%	23%	3%
About Right	68	67	69	82
Too Restrictive	5	7	8	15

The questions were "What is your view about current fiscal policy – is it too stimulative, too restrictive, or about right?" and "What is your view about recent monetary policy actions – have they been too stimulative, too restrictive, or about right?"

Other Issues

As in the August 1983 survey, the business economists were asked several questions about the international economy. When asked whether "in view of recent developments" international debt problems were more or less serious than before, 32 percent said more serious and 15 percent less serious, with the remainder taking the "about the same" position. This was a slightly more pessimistic viewpoint than that expressed in August, but when asked if they expected a major debtor country to default in the next 6 months, only about 15 percent said yes. The final question in this area – again repeated from August – asked for the change expected in the international value of the dollar, "calculated on a trade-weighted basis," between the survey date and the end of the year. One-eighth expected an increase, about three-fifths expected a decrease, and about one-quarter believed there would be no change, all of which represented a substantial shift from August to November toward an expectation that the dollar's value would decline. In fact the dollar remained quite strong relative to other currencies through the end of 1983.

Finally, NABE members were asked "in which year do you expect the peak of the current [business] cycle to occur?" Answers are displayed in Table 4; since the reader may be interested, they are distributed by the primary affiliation categories even though cell sizes are undesirably small for some groups. Overall, the modal year expected to mark the end of the current expansion turned out to be 1985, with about a fifth of the business economists seeing an even earlier end. Hardly anyone in the sample (only 5 percent) expected the current expansion to last beyond 1986, which would make it somewhat shorter than the average postwar business cycle expansion.

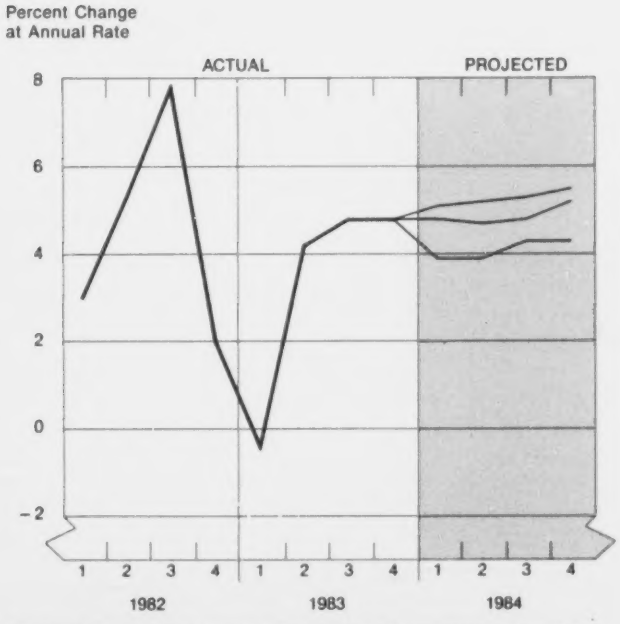
Errata: Because of a misunderstanding, our composing and printing firm changed the time span on several charts in the Autumn 1983 issue from 1958-83 (correct) to 1959-84. The affected charts are the one displaying the Index of Consumer Sentiment on page 78 and all charts on pages 93-95. In all cases the initial year should have been 1958 and the concluding year 1983. The shaded areas (screens) for the two charts on page 90 were also placed incorrectly. They should have covered the projected data quarters 1983:4-1984:3, just as the screens properly do for the charts on pages 74 and 77. We regret these errors and any puzzlement they may have caused our readers.

TABLE 4. Expected Year for Peak of Current Business Cycle by Primary Affiliation of Business Economists

Response Category	Primary Affiliation Group						
	Manufacturing	Nonbank Finance	Trade Associations & "Other"	Government & Academic	Commercial Banking	Consulting	All Groups
1984 or Earlier	18%	10%	28%	28%	16%	17%	20%
1985	55	50	52	61	50	48	53
1986	22	40	12	11	22	35	22
1987 or Later	4	0	8	0	12	0	5

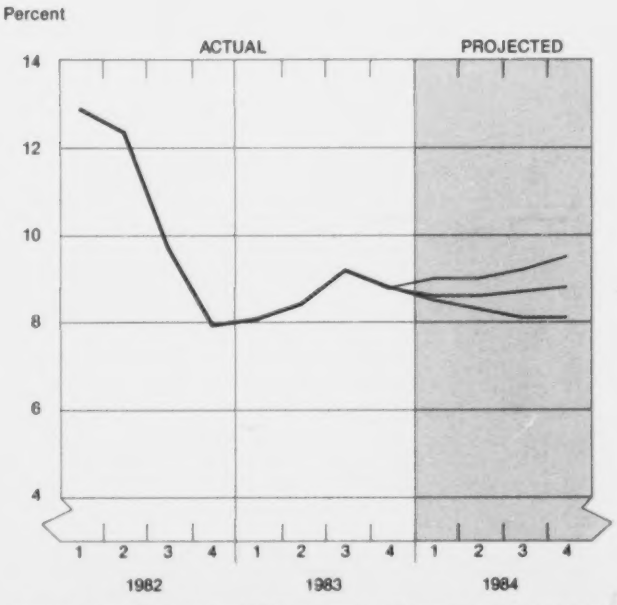
The question was "Most economists agree that the business cycle is still very much with us. Assuming that's the case, in what year do you expect the peak of the current cycle to occur?"

CONSUMER PRICE INDEX



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

90-DAY TREASURY BILL RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Actual		Proj.
	1982:2	1982:3	1982:4	1983:1	1983:2	1983:3	1983:4	1983:4	1984:1	1984:2	1984:3	1984:4	1982	1983	1984
GROSS NATIONAL PRODUCT	3,070	3,091	3,110	3,172	3,272	3,362	3,432	3,447	3,525	3,603	3,687	3,770	3,073	3,309	3,649
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	206.1	208.0	210.0	212.8	214.6	216.4	218.5	218.7	221.7	224.7	227.7	230.6	206.9	215.6	226.0
CORPORATE PROFITS AFTER TAXES	117.4	116.5	113.5	108.2	127.2	144.1	NA	149.7	155.0	161.0	167.0	172.2	115.1	NA	164.0
UNEMPLOYMENT RATE (percent)	9.43	10.00	10.60	10.37	10.10	9.40	8.47	8.90	8.60	8.50	8.30	8.10	9.72	9.58	8.30
INDUSTRIAL PRODUCTION (index, 1967 = 100)	139.4	138.2	135.3	138.5	144.5	151.8	156.0	156.0	158.0	160.1	162.7	164.2	138.6	147.7	161.4
NEW PRIVATE HOUSING UNITS STARTED (millions)	0.950	1.122	1.261	1.694	1.683	1.791	1.692	1.650	1.690	1.700	1.750	1.725	1.059	1.715	1.720
CONSUMER PRICE INDEX (% change from prior quarter or year)	5.3	7.8	2.0	−0.4	4.2	4.8	4.8	5.0	5.0	4.9	5.0	5.4	6.2	3.2	5.0
3-MONTH TREASURY BILL RATE (%)	12.36	9.71	7.94	8.08	8.42	9.19	8.79	8.80	8.60	8.60	8.70	8.80	10.72	8.62	8.80
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	15.65	14.72	12.22	11.99	11.57	12.68	NA	12.38	12.03	12.00	12.00	11.90	14.68	NA	12.00
GNP IN 1972 DOLLARS	1,489	1,486	1,481	1,490	1,525	1,553	1,571	1,575	1,592	1,609	1,627	1,643	1,485	1,535	1,616
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	969	971	980	987	1,011	1,016	1,032	1,031	1,041	1,049	1,058	1,068	970	1,011	1,054
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	167.1	163.3	160.5	159.9	163.0	170.1	178.9	173.0	175.4	179.0	182.0	184.9	166.1	168.0	180.1
RESIDENTIAL FIXED INVESTMENT (1972 $)	37.8	36.5	40.6	45.5	52.6	56.8	56.1	57.0	57.0	58.0	59.0	60.0	37.8	52.8	58.5
CHANGE IN BUSINESS INVENTORIES (1972 $)	−3.4	−1.3	−22.7	−15.4	−5.4	3.8	7.5	9.7	9.6	12.0	12.0	13.1	−9.4	−2.4	11.7
NET EXPORTS (1972 $)	33.4	24.0	23.0	20.5	12.3	11.4	2.5	7.0	6.0	6.4	6.0	6.8	28.9	11.7	6.2
FEDERAL GOVERNMENT PURCHASES (1972 $)	110.3	116.9	124.4	118.4	117.6	118.9	116.9	120.0	122.0	124.0	126.0	127.5	116.5	118.0	125.0
STATE AND LOCAL GOVERNMENT PURCHASES (1972 $)	175.4	175.3	175.2	174.5	174.5	176.3	176.3	178.0	179.0	180.0	180.8	182.0	175.2	175.4	180.0

SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1981:1	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1983:3	1983:4	1981	1982	1983
GROSS NATIONAL PRODUCT	2,867	2,913	3,005	3,032	3,021	3,070	3,091	3,110	3,172	3,272	3,362	3,432	2,954	3,073	3,309
PERSONAL CONSUMPTION EXPENDITURES	1,803	1,836	1,886	1,904	1,939	1,973	2,009	2,047	2,073	2,147	2,181	2,233	1,857	1,992	2,159
GROSS PRIVATE DOMESTIC INVESTMENT	455.5	472.1	495.8	476.2	422.9	432.5	425.3	377.4	404.1	450.1	501.1	529.8	474.9	414.5	471.3
NET EXPORTS	31.9	21.1	22.8	29.2	29.9	33.3	0.9	5.6	17.0	−8.5	−18.3	−32.6	26.3	17.4	−10.6
GOVERNMENT PURCHASES	576.3	583.5	600.3	622.8	629.8	631.6	655.7	679.7	677.4	683.4	698.3	701.7	595.7	649.2	690.2
DISPOSABLE PERSONAL INCOME	1,968	2,010	2,092	2,121	2,128	2,159	2,192	2,228	2,256	2,301	2,362	2,424	2,048	2,177	2,336
PERSONAL SAVING RATE (% of disposable income)	5.7	6.0	7.2	7.5	6.1	5.9	5.6	5.4	5.4	4.0	4.9	5.1	6.6	5.8	4.9

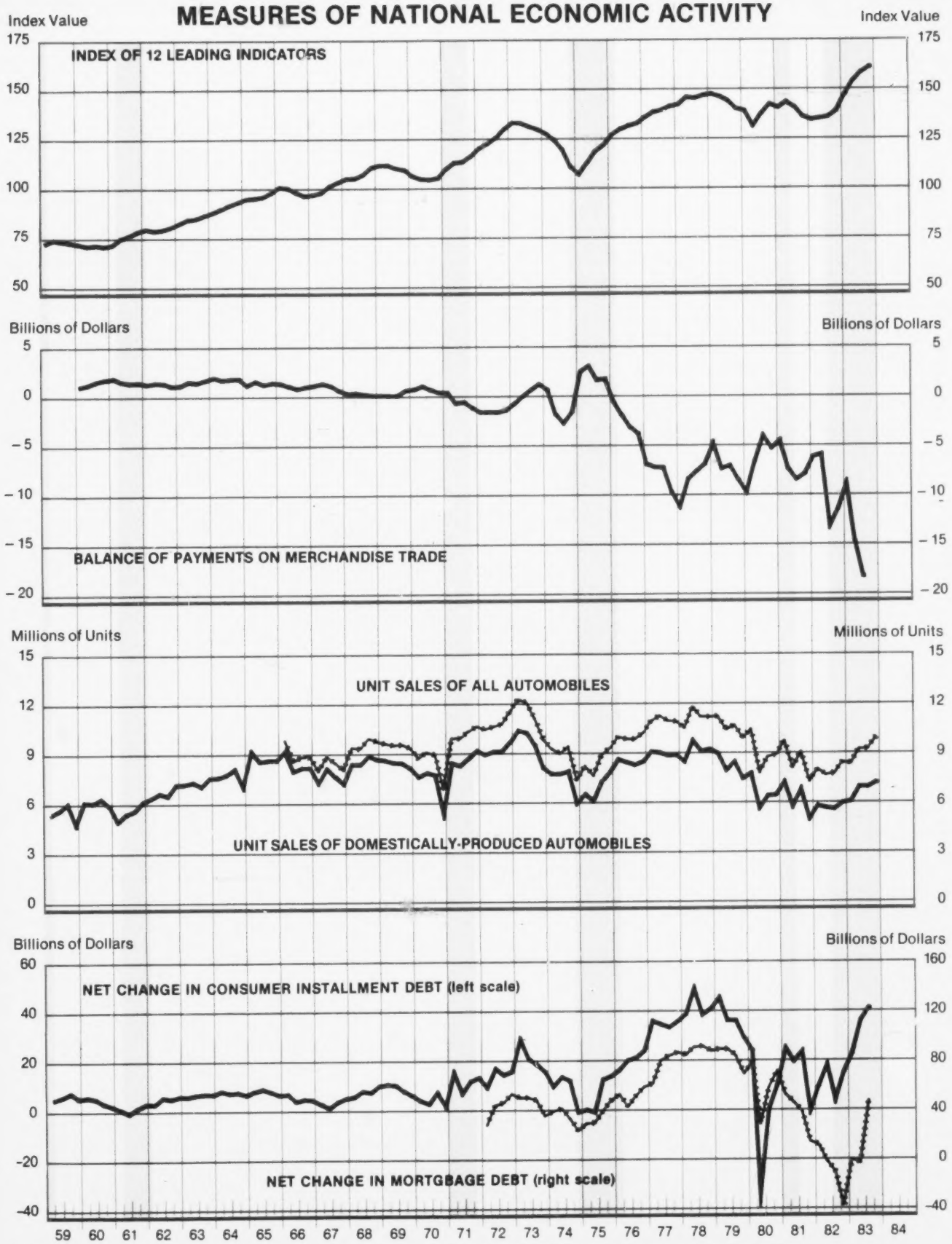
Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late January, and projected data, released by ASA-NBER in December, are displayed for fourth quarter 1983.

Sources: Projections: American Statistical Association – National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

BEST AVAILABLE COPY

Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY

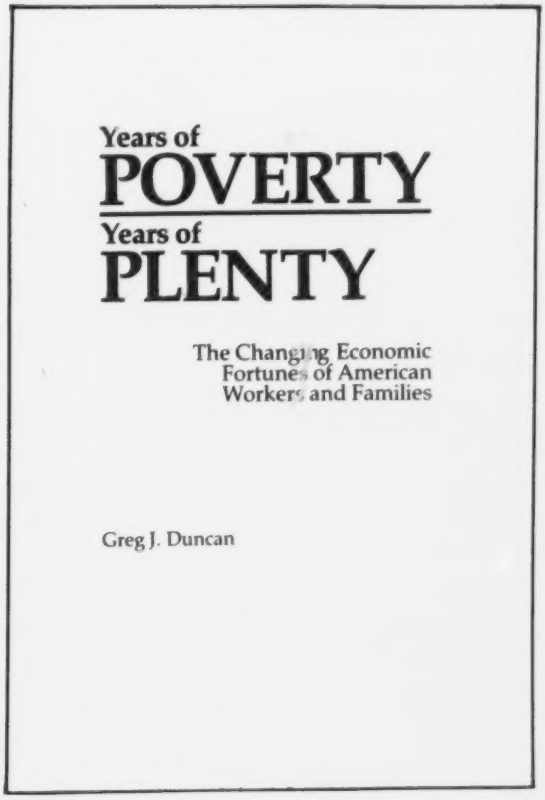


Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY

Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Sheds new light on welfare use and family economics in America...



This volume explores the economic ups and downs experienced by a large and representative sample of American families from 1969 through 1978. Author Greg J. Duncan—along with colleagues Richard D. Coe, Mary E. Corcoran, Martha S. Hill, Saul D. Hoffman, and James N. Morgan—has distilled ten years of economic, behavioral, and attitudinal data from ISR's ongoing Panel Study of Income Dynamics.

This long-term perspective on families reveals some previously unobserved patterns in American life, contradicting much of what has been inferred from cross-sectional survey information about the causes and extent of change in family economic well-being. The data reveal that American households actually undergo an astonishing amount of change in terms of family composition, occupations, income levels, and labor force participation.

The researchers found that welfare touches may lives: One in every four Americans lived in a family that received welfare during at least one of the ten years studied. But the findings also showed that there is substantial turnover among the poverty population, contradicting the popular notion that poverty tends to be an inescapable, self-perpetuating condition.

Exploring the dynamics of poverty and welfare use, the researchers found that changes in family composition are crucial explanatory factors, with divorce or separation imposing a devastating economic cost in the impoverishment of women and their children.

Other major findings include an assessment of changes in the economic status of black working men over the past two decades, and an examination of the unchanging wage gap between working women and their male counterparts.

The results and conclusions from these unique data have important implications for social science theory and for the social and economic policies that are based on that theory.

Contents

- An Overview of Family Economic Mobility
- Dynamics of Poverty
- Dynamics of Welfare Use
- Dynamics of Work Hours, Unemployment, and Earnings
- Recent Trends in the Relative Earnings of Black Men
- Do Women "Deserve" to Earn Less Than Men?
- References
- Glossary/Index

1984 / 200 pages / ISBN 0-87944-285-9 / cloth $24

Order from: ISR Publications Sales
Institute for Social Research
The University of Michigan
P.O. Box 1248
Ann Arbor, MI 48106-1248

All orders from individuals must be prepaid

ECONOMIC OUTLOOK USA SRC—P.O. Box 1248 Ann Arbor, MI 48106

ECONOMIC OUTLOOK USA

SPRING 1984
Vol. 11 No. 2

A quarterly publication of the
SURVEY RESEARCH CENTER
Institute for Social Research
THE UNIVERSITY OF MICHIGAN

Victor Zarnowitz
How Healthy and Durable is the Current Expansion?
Richard J. Curtin
The Reign of Optimism
Richard E. Barfield
Business Economists Foresee Continued Expansion but Urge Action on Deficits
Thornton and Freedman
The Changing American Family: Marriage and Divorce

ECONOMIC OUTLOOK USA (USPS 330-690)
SPRING 1984 Vol. 11 No. 2

Published Quarterly by the
SURVEY RESEARCH CENTER
THE UNIVERSITY OF MICHIGAN
426 Thompson Street
P.O. Box 1248
Ann Arbor, Michigan 48106

EDITOR'S NOTE:

ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis of this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

The opinions expressed in this publication represent those of individual authors and do not necessarily reflect the views of the Survey Research Center or The University of Michigan. The editor, as a matter of policy, makes no attempt to reconcile divergent opinions.

SUBSCRIPTIONS:

Regular Subscribers, $27.00 U.S. per year
Academic Subscribers, $13.00 U.S. per year (available to *individual faculty and students* only)

Quantity subscriptions are available at substantial discount. For 1-99 subscriptions, contact the Circulation Manager at the Survey Research Center address (phone: 313–763-5169). Subscribers to 100 or more copies may use their own imprint on the front cover and may use the back cover for a message to customers, executives, and others. Direct inquiries to the Executive Editor at the Survey Research Center (phone: 313–763-5196).

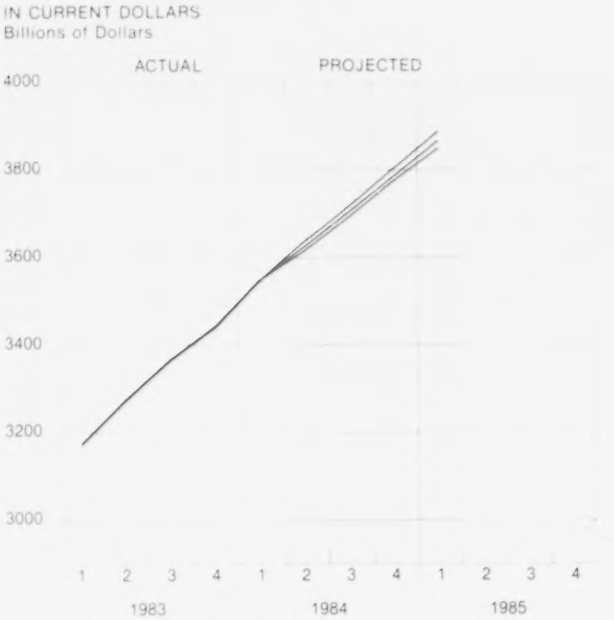
EDITOR: F. Thomas Juster
EXECUTIVE EDITOR: Richard Barfield
CIRCULATION MANAGER: Nellie Beaubien

Editorial Board:
Richard Barfield
Richard T. Curtin
F. Thomas Juster
Paul W. McCracken
James N. Morgan
Burkhard Strumpel
Victor Zarnowitz

© 1984 by the University of Michigan. Second-class postage paid at Ann Arbor, Michigan. **Postmaster:** send address changes to ECONOMIC OUTLOOK USA, at the address given above. Printed in the U.S.A.

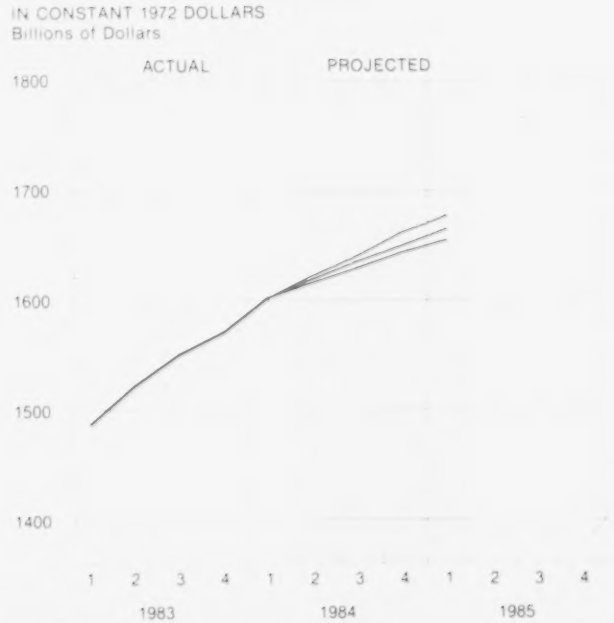
ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

How Healthy and Durable Is the Current Expansion?

Victor Zarnowitz
Professor of Economics and Finance
The University of Chicago

The Recession and Disinflation of 1980-82

In 1980-82 the U.S. economy suffered two recessions separated by an aborted recovery. There was no net growth in total real output over these three years, industrial production declined substantially, and unemployment soared from 6 percent to nearly 11 percent of the labor force. The cyclical movements in credit flows and interest rates were very sharp. The monetary growth rates fluctuated in a highly volatile manner. Inflation rates fell unevenly but strongly, from double-digit levels in 1980 to less than 3 percent late in 1982. Interest rates, too, dropped eventually in the course of the 1981-82 recession. However, the declines in interest rates tended to be considerably smaller in relative terms than the declines in inflation rates.

The disinflation of 1980-82, like that of 1974-75, was largely unanticipated, that is, heavily underpredicted at the time. As the recession proved longer and more severe than expected, however, nominal wage demands greatly moderated, and there were even some widely publicized "givebacks" in labor contracts. Yet changes in real compensation of employees in the nonfarm business sector, which tended to be negative since 1978, turned predominantly positive during the 1981-82 contraction. Labor costs per unit of output definitely decelerated in 1982 before actually declining during the recovery of 1983.

Financial costs were greatly reduced as well. Growth of manufacturing and trade inventories was halted, then reversed. Expenditures on new plant and equipment contracted with the usual lags behind new appropriations and orders. Interest rates on business loans from banks fell rapidly on the average from the vicinity of 20 to that of 10 percent.

All this helped business concerns to "reliquefy," that is, gradually restore strength to their balance sheets by cutting back on loans, reducing outstanding liabilities, and improving the quality of their assets. In the meantime, the leading indicators began to predict the upturn in general economic activity. The earliest maintained signals came from the deflated monetary aggregates, new housing starts and permits, change in sensitive materials prices, vendor performance (slowing of deliveries), and change in stocks of materials and supplies on hand and on order, roughly in this sequence. The upturn in the composite index of leading indicators preceded the business cycle trough by 8 months, the longest lead in the post-World War II period, but it was a moderate and gradual movement which at the time many disregarded or disbelieved. However, the sharp rise in the stock market in the late summer and fall of 1982 confirmed the nearness of the business cycle trough, which was later dated November by the National Bureau of Economic Research. Soon consumer sentiment and purchases of durable goods began visibly to improve and add to the gathering forces of recovery.

Aggregate demand and supply interacted as usual. Increased price-cost ratios, profit margins, and cash flows paved the way to a recovery in this recession as they did in so many previous ones.

Private-Sector Behavior and Public-Policy Concerns

It is important to recall these developments leading to the current business expansion in order to recognize that the observed changes originated in large part from the working of the economy itself rather than the fiscal and monetary policy actions which typically attract most of the public attention. To be sure, the Federal Reserve permitted the monetary aggregates (M1 and M2) to increase substantially late in 1982 and early in 1983, which helped the upturn. Inflation stayed low at the time and real money balances rose strongly (their growth decelerated later in 1983). But the velocity of money (or income-to-money-supply ratios) had surprisingly large declines throughout the 1981-82 recession and flattened only in 1983 when interest rates stopped falling. It is for good reasons that the role of changes in the demand for money and of the credit flows has received a great deal of new analytical interest in this period, coinciding also with the deregulation of and major innovations in the financial sphere.

Having strongly underestimated the 1982 disinflation and contraction a year before, many forecasters similarly underestimated the 1982 recovery as it began to unfold, on the ground that monetary policy had been too tight for too long and that high real interest rates would prevent a vigorous upswing. Large errors of underprediction of cyclical movements in both 1982 and 1983 were made by some Keynesian and monetarist economists alike.

Despite an intense public scrutiny of fiscal policy, its macroeconomic implications were long overstated or misunderstood. In constant dollars, the rise of federal government purchases of goods and services during 1981-82 was largely offset by the weakness of state and local government purchases. Tax cuts did not become effective overall before 1983.

The high domestic interest rates and political unrest and uncertainties abroad combined to cause large inflows of foreign capital. This external demand for U. S. securities has helped to finance our fiscal deficits since 1980, but the resulting strength of the dollar has contributed strongly to the persistent erosion in real terms of net U. S. exports of goods and services. Although this was not an unanticipated development, its duration and magnitude were widely underpredicted.

The Recovery and Expansion of 1983-84

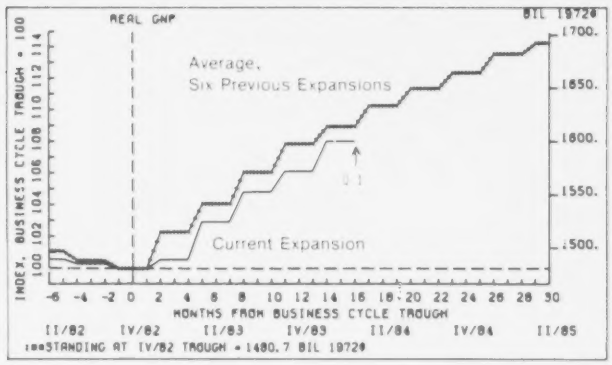
The upward movement in total employment and output which started in the last quarter of 1982 refused to conform to the pessimistic forecasts and did not turn out to be weak at all. In the five quarters recorded so far since the trough, virtually all indicators of macroeconomic performance have improved greatly. Real GNP—total output of goods and services—gained some 120 billion of 1972 dollars or 8 percent. Total civilian employment rose from 99 to about 104 billion persons or 5 percent. The rate of unemployment fell below 8 percent of the labor force. Output of factories,

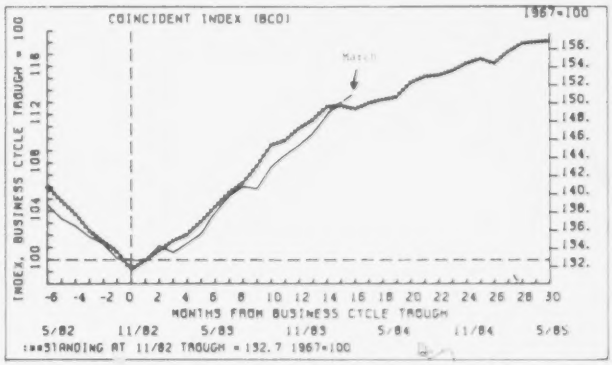
mines, and utilities rose 19 percent and its durable-manufactures component 26 percent. Capacity utilization in manufacturing increased from less than 70 to about 80 percent.

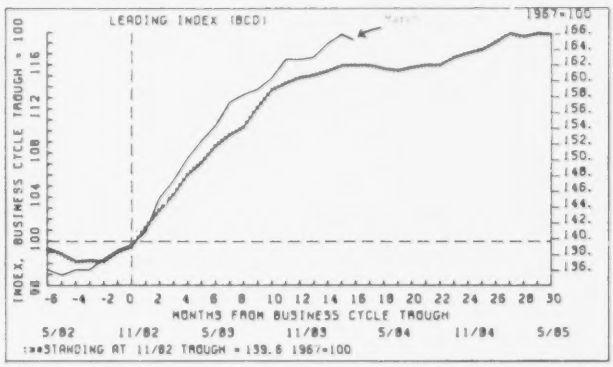
In fact, quarterly real GNP and the monthly index of coincident indicators as well as its several components have followed closely the average path of six previous post-World War II expansions, as shown by the accompanying charts.[1] For these and some related series (nonfarm employment, real personal income) the current-cycle patterns run parallel to but a little below the average-cycle patterns. Industrial production would have been almost perfectly predicted by the simple device of averaging the movements of the series over the corresponding interval of the earlier business cycles. For the index of leading indicators the parallelism is likewise close, but here the current curve is positioned a few index points above the historical averages. This reflects the movements of some leading series such as housing starts and materials prices. For some other leaders—contracts and orders for plant and equipment, change in inventories, stock prices—the patterns overlap and cross.

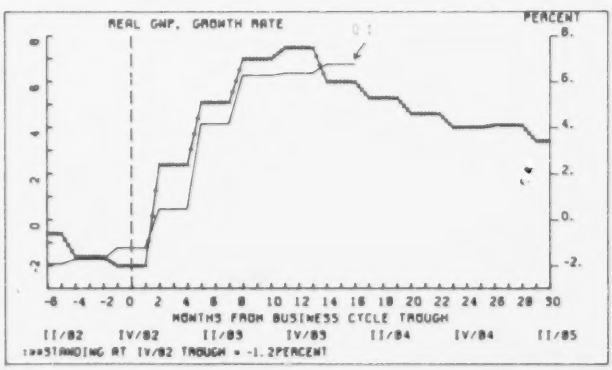
In comparisons involving percentages or ratios—growth rates of output, prices, money, and debt; the unemployment rate; inventory/sales ratio—the figures plotted are data proper rather than deviations from trough standings. Here the patterns are often closely correlated but very different in levels as in the case of unemployment, which has fallen somewhat faster than the average but from a very high peak. The decline in inventories relative to sales has been particularly large. Corporate profit margins have risen more than usual, but their level is still below the average. However, the growth rates of total real GNP in 1983-84 have been very close to the historical track.

The monetary growth rates increased sharply in the year centered on the business cycle trough but have fallen strongly since then. Their course lies well above the average. The pattern for the growth in federal debt is similar, only still more elevated. For business and consumers, the picture is just the reverse: a decline in the debt growth during the year around the trough, a steep upswing afterwards. When the public and private debts are combined, a procyclical pattern of growth emerges that is fairly similar to the average path but higher and steeper in recent months. The current curves for interest rates are way above their historical counterparts, of course. Disquietingly, inflation in terms of CPI has moved up at a faster than average pace in the last year, and so has a composite of several series that historically tended to anticipate inflation.[2]


REAL GNP
BIL 1972$
Average,
Six Previous Expansions
Current Expansion
INDEX, BUSINESS CYCLE TROUGH = 100
MONTHS FROM BUSINESS CYCLE TROUGH
II/82 IV/82 II/83 IV/83 II/84 IV/84 II/85
STANDING AT IV/82 TROUGH = 1480.7 BIL 1972$

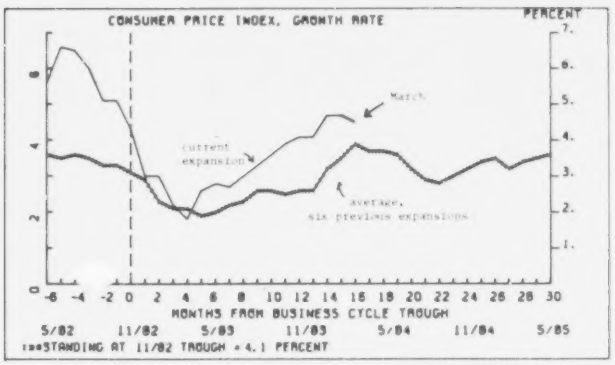

COINCIDENT INDEX (BCD)
1967=100
INDEX, BUSINESS CYCLE TROUGH = 100
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 132.7 1967=100

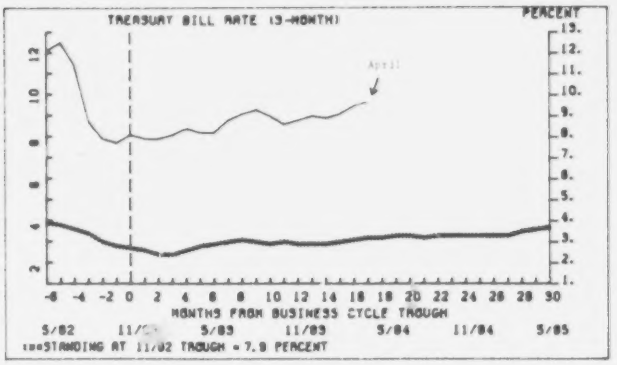

LEADING INDEX (BCD)
1967=100
INDEX, BUSINESS CYCLE TROUGH = 100
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 139.8 1967=100

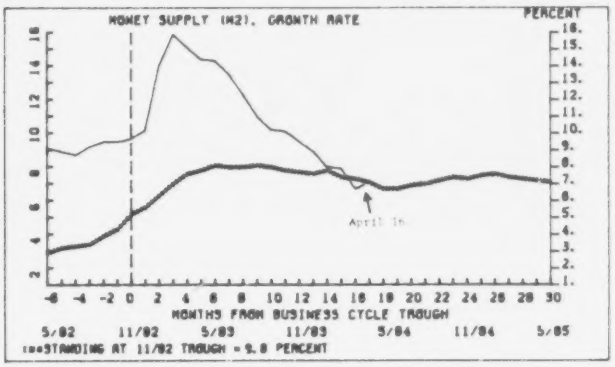

REAL GNP, GROWTH RATE
PERCENT
MONTHS FROM BUSINESS CYCLE TROUGH
II/82 IV/82 II/83 IV/83 II/84 IV/84 II/85
STANDING AT IV/82 TROUGH = -1.2PERCENT

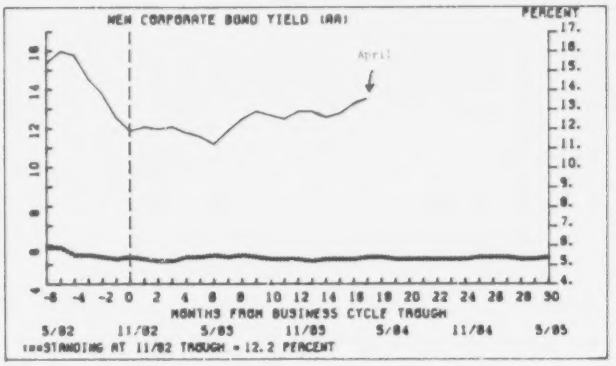
[1]The six expansions are 1949-54, 1954-57, 1958-60, 1961-69, 1970-73, and 1975-80. The 1980-81 recovery, which lasted 12 months only and was atypically weak, is not included in the average patterns. The figures shown for the levels represent indexes with the three-month average centered on the initial business cycle trough equal to 100. For the underlying data, see *Business Conditions Digest* (BCD), a monthly report of the U. S. Department of Commerce, Bureau of Economic Analysis. The charts are updated and reproduced by permission from *Recession-Recovery Watch*, a bimonthly report published by the Center for International Business Cycle Research (CIBCR), Columbia Business School, Columbia University, New York.

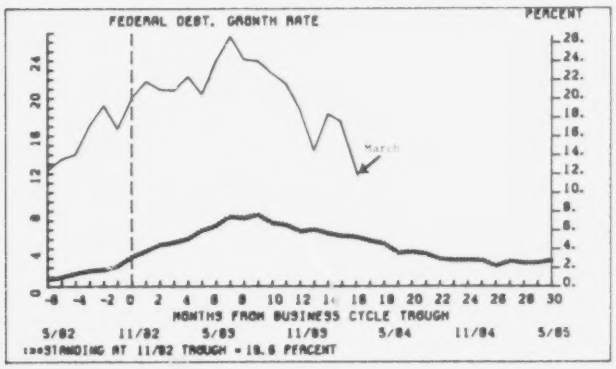
[2]The growth rates in the charts are six-month (or two-quarter) smoothed rates obtained by dividing the current month's (quarter's) value by the average for the 12 preceding months (or 4 quarters), and expressing the result as a compound annual rate. The leading index of inflation computed by CIBCR, Columbia University, is a composite of the annual rates of change in industrial materials prices and in total debt outstanding and the ratio of civilian employment to total population of working age.

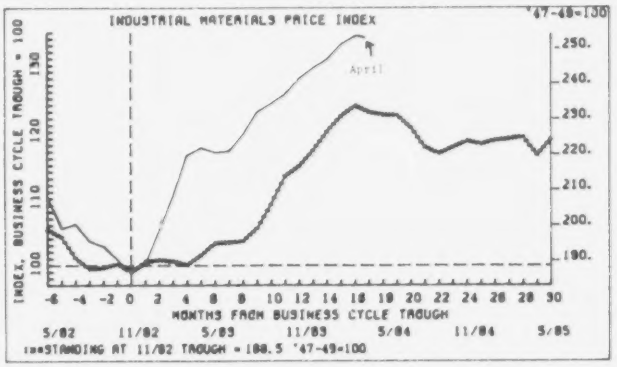

CONSUMER PRICE INDEX, GROWTH RATE
PERCENT
March
current expansion
average, six previous expansions
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 4.1 PERCENT

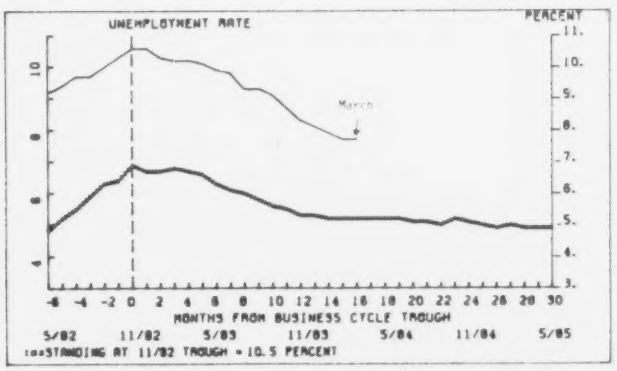

TREASURY BILL RATE (3-MONTH)
PERCENT
April
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 7.9 PERCENT

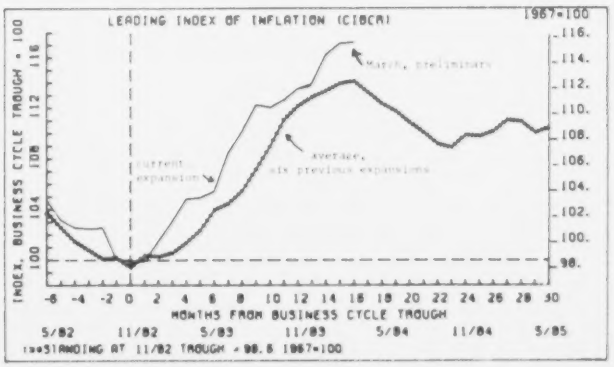

MONEY SUPPLY (M2), GROWTH RATE
PERCENT
April
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 9.8 PERCENT


NEW CORPORATE BOND YIELD (AA)
PERCENT
April
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 12.2 PERCENT


FEDERAL DEBT, GROWTH RATE
PERCENT
March
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 18.8 PERCENT


INDUSTRIAL MATERIALS PRICE INDEX
'47-49=100
INDEX, BUSINESS CYCLE TROUGH = 100
April
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 188.5 '47-49=100


UNEMPLOYMENT RATE
PERCENT
March
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 10.5 PERCENT


LEADING INDEX OF INFLATION (CIBCR)
1967=100
INDEX, BUSINESS CYCLE TROUGH = 100
March, preliminary
current expansion
average, six previous expansions
MONTHS FROM BUSINESS CYCLE TROUGH
5/82 11/82 5/83 11/83 5/84 11/84 5/85
STANDING AT 11/82 TROUGH = 98.6 1967=100

In sum, the record shows that the current expansion in employment and output has been about average: neither too weak nor too strong and hence much less vulnerable than many had feared. The evidence from leading indicators is generally consistent with the projection that the expansion will continue at a pace close to or somewhat higher than the average. However, early warnings concerning a possible renewal of serious inflationary pressures begin to emerge. There are dangers both in ignoring such warnings if they continue and in overreacting to them.

Reviewing the Forecasts

The predominant view among forecasters is that the economy will continue expanding at least through mid-1985, although at rates averaging considerably lower than those observed hitherto. This is supported, for example, by the median predictions from the February survey of the American Statistical Association and the National Bureau of Economic Research as well as by many other private and public forecasts issued in the first quarter of this year. The evidence from the average historical patterns is consistent with such expectations. Indeed, few of those who circulate numerical forecasts for 1985 and 1986 (the major econometric service bureaus, some corporate economists) seem prepared to go on record in saying that another recession will take place during this longer period. Yet a broad survey asking the question directly in November 1983 found that 20 percent of the responding members of the National Association of Business Economists thought it likely that the "peak of the current cycle" will occur in 1984, 53 percent in 1985, 22 percent in 1986, and 5 percent in 1987 or later (see Richard Barfield's report in the Winter 1984 issue of ECONOMIC OUTLOOK USA).[3] Apparently the events of the last two decades have revived the belief that "the business cycle is still very much with us," as was stated in that survey question.

Most forecasters until recently continued to anticipate that inflation will creep upward but very slowly and that interest rates will be fairly stable, though more likely to rise than decline. They predicted strong corporate profits for 1984, slower gains for 1985; an end to the housing expansion and less growth in consumption and state and local government purchases in the year ahead; net exports nearing a nadir; but also large increases in business investment and federal government purchases, in large measure for defense (all expenditures being measured in constant dollars).

These forecasts preceded several late news items. The prime rate was raised twice in less than a month and reached 12 percent. Banks pleaded higher costs of funds they borrow, and it is clear that the private demand for credit is rising strongly. The stock market closed on Friday April 6 at the lowest level in nearly a year. Later the Federal Reserve raised the discount rate by ½ point to 9 percent.

These developments are bound to worsen the long-held fears of some (mainly Wall Street) analysts that this expansion is heading toward an unsustainable boom and another credit crunch severely aggravated by the unprecedented and uncontrolled federal budget deficits. The financial markets seem preoccupied with the threatening if somewhat vague prospects for either an inflationary monetization of public-debt rises or a new runup of interest rates.

[3]Rather similar responses to the same question were forthcoming in the February 1984 NABE survey. See Barfield's article in this issue.

Certainly, the accumulation of huge fiscal deficits with relatively low rates of private saving is a very real cause for serious concern at the present time when a continuing expansion will have to be financed increasingly by private domestic borrowing. Contrary to recent predictions by some (but not all) monetarist economists, the decline in monetary growth rates which occurred in 1983 has yet to show any effect of chilling (or even merely cooling) the expansion. Financial market economists worry instead about too much fiscal stimulus making for an overheated economy increasingly running into supply bottlenecks and rises in prices of commodities, labor, and credit. According to their scenario, strong restrictions would be necessary to reduce the growth of demand to the feasible growth of supply that the economy can produce; but such fiscal and monetary tightening is unlikely as long as the revival of inflation is not yet evident and alarming. So the most likely outcome is a boom with much higher inflation and interest rates in 1985, spreading abroad and causing the dollar to fall. If the already long overdue steps to reduce the fiscal deficits decisively were taken in time, the expansion could be prolonged by avoiding the new boom-and-bust sequence. Next year, however, it will be too late for that, and the expansion will probably end prematurely as a result of financial disturbances in the U. S. and abroad triggering another recession.

This pessimistic forecast is by no means implausible: similar sequences of events happened before when a rapid rise in demand would not be accommodated on the credit and supply side. But it is not yet clear that the economy is about to overheat, and the scenario is certainly not predetermined. The notion that the Fed will resist an out-and-out boom is probably right, but there is still much unemployed labor and capacity around. The alternative forecast that real growth will slow considerably in the year ahead also draws much support from history and still seems to represent the majority view. If a breathing spell is granted the economy in the year ahead and a significant deficit-cutting package is finally passed, a continued runup of interest rates may after all be avoided.

Nonetheless the danger of a premature revival of inflationary pressures (possibly aggravated by large wage settlements or a major strike) is growing. The indicator analysis of the previous section is consistent with inflation rising to 7-8 percent in the year ahead. It is likely that the Fed is apprehensive of such prospects, too. Some Fed-watchers in the public as well as the private sector are apt to contemplate still another possibility, namely that the Fed may overreact and impede the economy's progress. But this also is highly speculative at this point.

The expansion has been very healthy indeed for the U. S. economy so far, but its vigor and durability are uncertain. The high real growth rates of 1983:2-1984:1 are clearly not sustainable. Lower growth supported by higher rates of investment in plant and equipment and lower rates of consumer and government spending is now desirable, and we may get it for some time with some luck and caution. The prescription for a healthier economy is clear: a long period of what we had earlier in this recovery, real growth with little inflation and at least stable if not lower interest rates. Overheating is a threat but a tighter monetary policy should be avoided. On the positive side, the main policy requirements are to reduce fiscal deficits and work at promoting international trade and lowering the risk of acute foreign debt crises.

April 1984

The Reign of Optimism

Richard T. Curtin
Director, Surveys of Consumer Attitudes
Survey Research Center
The University of Michigan

Consumer Confidence Reaches Record Level

The Index of Consumer Sentiment stood at 99.5 in the first quarter 1984 survey, the highest level recorded since the first quarter of 1966 (the base survey). The first quarter 1984 reading was 8 Index points above the plateau of 91.5 recorded in the second through fourth quarters of 1983, and 24.2 Index points above the year-earlier reading. The recent improvement has been due to more favorable assessments of the economy as a whole and more favorable evaluations of buying conditions.

It has been nearly four years since the all-time low in the Index of Consumer Sentiment was recorded in the second quarter of 1980. The Index has nearly doubled since then, rising from 54.4 to 99.5. Most of the four-year increase, however, was recorded during two separate six-month periods. The first substantial increase was recorded immediately following the record low, when the Index rose from 54.4 in the second quarter to 72.1 in the fourth quarter of 1980. Two years later, in the fourth quarter of 1982, the Index still stood at 72.5. The second period of rapid improvement was recorded from the fourth quarter of 1982 to the second quarter of 1983, when the Index rose from 72.5 to 91.5. The Index then remained at that much improved level through the balance of 1983. The two short periods of rapid improvement, as well as the prolonged periods at low levels and at high levels, has been due largely to interest rate developments. That the last recovery was halted by high interest rates has not been forgotten by the consumer, and, despite otherwise very favorable views, interest rate increases now expected by consumers are seen as darkening clouds on the economic horizon.

Family Finances Best in Decade

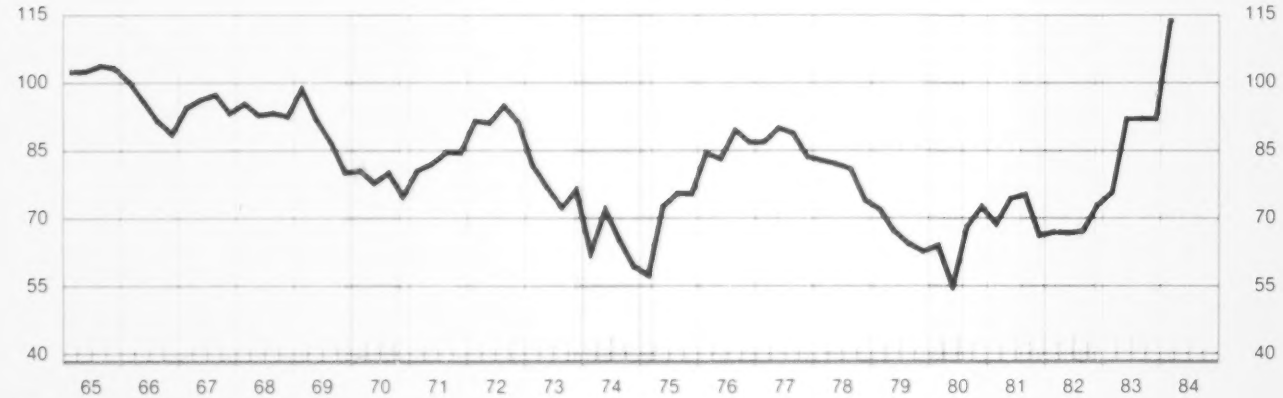
By the start of 1984 the financial situation of American families had improved substantially over the conditions that prevailed one year earlier. In the first quarter 1984 survey, evaluations of both recent financial progress and expected improvement during the year ahead remained at or near decade peaks. In addition, these favorable short-term evaluations of personal finances are now accompanied by more favorable longer-term evaluations.

In the first quarter 1984 survey, 45 percent of all families reported that their financial situation had improved, up from 30 percent one year earlier, and the highest proportion recorded since 1972. When asked to explain how their financial situation had changed, families more frequently mentioned receiving income increases in the first quarter of 1984 than one year earlier (35, up from 27 percent). Complaints about the adverse impact of inflation on family budgets fell to 15 percent in the 1984:1 survey, down from 23 percent one year earlier, and 44 percent three years earlier.

Not only have reports of recent financial progress become more favorable, but American families also expected continued improvement during the year ahead. Among all families in the first quarter 1984 survey, 41 percent expected their personal financial situation to improve, regaining the cyclical peak first reached in the second quarter of 1983. Increases in family incomes during the year ahead were expected by 64 percent of all families in the survey, up from 53 percent one year earlier. Just 9 percent of all families expected income declines in the 1984:1 survey, down from 17 percent one year earlier.

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

The cumulative impact of these recent improvements has established the most favorable longer-term evaluations of personal finances recorded during the past decade. Among all families, 58 percent reported in the first quarter 1984 survey that their current financial situation had improved compared with five years earlier, up from 47 percent in the first quarter 1983 survey. Unfavorable evaluations of the longer-term trends in their financial situation were reported by 27 percent of all families, down from 38 percent one year earlier. Longer-term personal financial expectations have also improved. Among all families, 54 percent expected their personal financial situation to improve during the next five years, up from 52 percent one year earlier, and 39 percent in 1980. In the 1984:1 survey, just 11 percent of all families expected their personal financial situation to worsen during the next five years, down from a peak of 26 percent recorded in the first quarter of 1980.

Willingness to Spend

The improved financial situation of American families has led to an increased willingness to use accumulated savings or to incur new debt in order to make major new purchases. Among all families in the first quarter 1984 survey, 40 percent reported their willingness to use accumulated savings in order to make major purchases, up from 29 percent one year earlier, and the highest level in more than five years. When asked about their willingness to incur new debt in order to make major purchases, 29 percent of all families reported their willingness to use credit, up from 18 percent one year earlier, and 12 percent three years earlier.

The rise in consumer predisposition to spend has been accompanied by favorable attitudes toward buying conditions for major household durables, vehicles, and houses. The major factor underlying the recent maintenance of favorable buying attitudes has been favorable perceptions of market prices.

Consumer attitudes toward buying conditions for large household durables reached record favorable levels in the first quarter 1984 survey. Among all families, 71 percent favorably rated buying conditions for durables, up from 53 percent one year earlier, and the highest proportion recorded during the last 30 years. Among all families, just 19 percent reported unfavorable buying conditions for large household durables, half the 38 percent recorded one year earlier. When asked to explain their views on market conditions for household durables, the appeal of lower prices and discounts was mentioned by 40 percent of all respondents, the highest quarterly level ever recorded. In comparison, just 10 percent of all families mentioned their aversion to high prices for household durables, down from 19 percent one year earlier, and the lowest level recorded since 1972.

Buying conditions for vehicles were viewed favorably by 64 percent of all families in the first quarter 1984 survey, reversing small declines recorded at year-end, and nearly regaining the all-time quarterly record of 65 percent in the second quarter of 1983. Because fewer households held unfavorable vehicle buying attitudes in the first quarter 1984 survey (25 percent) than in the second quarter 1983 survey (29 percent), the net balance of opinion was more favorable at the start of 1984. When asked to explain their views on buying conditions for vehicles, references to low prices and discounts remained as frequent in early 1984 as in early 1983 (24 percent), but references to high vehicle prices declined to 17 percent in early 1984 from 24 percent one year earlier, representing the lowest proportion recorded in more than five years. Fewer families mentioned the availability of lower interest rates on vehicle loans in the 1984:1 survey compared with one year earlier (22, down from 33 percent), and fewer consumers registered complaints about high interest rates (7, down from 13 percent).

Attitudes toward buying conditions for houses remained at very favorable levels in the first quarter 1984 survey. Among all families, 61 percent held favorable attitudes toward buying conditions for houses, up from 55 percent in the fourth quarter of 1983, and just below the cyclical peak of 64 percent recorded in the second quarter 1983 survey. The 1984:1 survey marked the fifth consecutive quarter in which consumer perceptions of market prices for houses have remained on balance favorable. This represents the most favorable perceptions of market prices for houses held by consumers in more than 20 years. Among all families, 17 percent reported the appeal of low prices and the availability of good housing buys, compared with 14 percent that cited their aversion to high housing prices. Just three years ago, in the first quarter of 1981, eight times as many respondents cited their aversion to high prices for housing (32 percent) as mentioned the appeal of low prices (4 percent).

Record Assessments of Economic Performance

The first quarter 1984 survey continued to record widespread awareness of the ongoing economic expansion. Reports that business conditions had improved during the past year were made by 71 percent of all respondents in the survey—the highest proportion recorded in more than 30 years. Much of the improvement, however, was recorded by mid-1983, when the proportion that reported improved business conditions doubled, rising from 27 percent in the first quarter of 1983 to 59 percent in the second quarter. The rise since then has been at a much slower pace.

When asked about news they had heard and could recall of recent economic developments, respondents in the first quarter 1984 survey reported twice as many favorable as unfavorable developments (67 versus 30 percent). These very favorable perceptions of recent economic developments have been primarily due to more favorable employment and unemployment trends. During the past year, respondents have reported hearing of increases in employment (rising from 17 to 26 percent), and much less frequently have reported news of spreading unemployment (falling from 35 to 12 percent). Overall, more than twice as many respondents to the 1984:1 survey expected unemployment to decline during the year ahead as expected it to increase (35 versus 15 percent).

The annual rate of inflation expected by consumers in the January 1984 survey was 4.9%, just above the cyclical low of 4.3% recorded one year earlier. The mean expected rate of inflation has declined substantially since the peak rate of 11.9% was recorded in the first quarter 1980 survey. In the three years from 1980 to 1983, the mean expected inflation rate declined by 7.6 percentage points, while a small increase of 0.6 percentage points was recorded during the past year. The sharp decline during the earlier period was accompanied by a shift in responses from inflation expectations of 10% or more (declining from 52 percent in 1980 to 14 percent in 1983), to the expectation that prices would remain unchanged or decline (rising from 10 percent in 1980 to 38 percent in 1983). The small increase in the overall mean recorded during the past year was accompanied by a shift

away from the expectation that prices would remain unchanged or decline (from 38 to 24 percent), and toward a greater concentration of price expectations in the 1-4% range (from 21 to 32 percent). This consolidation and reduction in the dispersion of price expectations indicates less consumer uncertainty about expected price trends.

Confidence in government economic policies to control inflation and unemployment reached new favorable levels in the first quarter 1984 survey. Among all families, 32 percent favorably rated government economic policies, up from 18 percent recorded one year earlier. Unfavorable ratings of governement economic policies were given by 18 percent of all families in the survey, half the 36 percent recorded one year earlier. This recent improvement restores the high level of confidence recorded in the early months of the Reagan administration.

Higher Interest Rates Expected to Slow Pace of Recovery

Although evaluations of recent economic progress are now at record levels, many fewer consumers expected that same rapid pace of economic improvement to continue during the year ahead. Among all families in the first quarter 1984 survey, the proportion that expected the economy to improve during the year ahead fell to 41 percent from the peak level of 52 percent recorded in the second quarter of 1983. Importantly, this decline in expectations for continued improvement was not mirrored by increases in the expectations of a renewed decline. Just 10 percent of all families in the 1984:1 survey expected the economy to worsen during the year ahead. Nearly half of all consumers (47 percent) expected the current improved level of the economy to be maintained during the year ahead.

The widespread expectation among consumers of higher interest rates represents the major reason underlying the expected slowing in the pace of economic expansion during the year ahead. Among all families in the first quarter 1984 survey, 40 percent expected interest rates to increase during the year ahead, twice the 20 percent recorded one year earlier. The proportion of families that expected interest rates to decline during the year ahead fell to 17 percent in the 1984:1 survey, from 42 percent one year earlier.

Although the rate of improvement is expected to slow, favorable economic conditions were expected to persist in the near and longer terms. In the first quarter 1984 survey, 69 percent of all families expected good times in the economy as a whole during the next 12 months, the highest level recorded in nearly 20 years. When asked about the prospects for the economy over the next five years or so, 44 percent of all families expected good times to persist over the longer term in the 1984:1 survey, the highest level recorded during the last 20 years. Four years earlier, in the first quarter of 1980, just 17 percent of all families expected good times in the economy as a whole over the longer term.

Federal Budget Deficits

In the March 1984 survey, respondents were asked about their views concerning the federal budget deficit, repeating questions asked in prior years. Awareness of the federal budget deficit was reported by 81 percent of all families in the survey, up significantly from the 55 percent recorded in 1973 and the 54 percent recorded in1961 (see Table 1). Few consumers thought that the federal budget was in balance in 1984 (6 percent) or in the earlier surveys. Importantly, the proportion of American families who reported they did not know whether the budget was in deficit or not has fallen over the past 20 years, to 10 percent in 1984 from 41 percent in 1961. The increased awareness of the federal budget deficit has also been acompanied by an increased concern. In the March 1984 survey, 45 percent reported that they were very concerned about the deficit, up from 23 percent in 1973.

TABLE 1. Awareness of the Federal Budget Deficit

Awareness and Concern	Nov. 1961	Feb. 1973	March 1984
Budget in Deficit	54%	55%	81%
Very Concerned	*na*	*23*	*45*
A Little Concerned	*na*	*22*	*29*
Not at all Concerned	*na*	*10*	*7*
Budget Balanced	4	9	6
Don't Know	41	35	10
NA	1	1	3
Total	100%	100%	100%
Cases	956	1348	700

The questions were: (Feb. 1973, March 1984) "Do you happen to know whether the federal government is spending more money than it is taking in, so that it is operating with a deficit at present, or are federal government revenues and spending pretty much in balance?"

(Nov. 1961) "Now I have a few questions about the federal government; do you happen to know whether the federal government is now operating with a deficit?"

(Feb. 1973, March 1984) "Is this deficit something about which you are very concerned, a little concerned, or not at all concerned?"

A more sensitive measure of the salience of federal budget deficits uses an indirect measurement approach. As part of the regular monthly monitoring of consumer attitudes and expectations, respondents are asked to explain in their own word the reasoning underlying their opinions. In the March 1984 survey, when asked about news of recent economic developments, just 2 percent of all families mentioned federal budget deficits. And when asked about why they expected business conditions to improve or worsen during the year ahead, just 4 percent mentioned the adverse impact of federal budget deficits. Consequently, the use of fixed-choice questions resulted in much higher levels of expressed concern with federal deficits.

When asked whether they expected the annual federal deficit to increase or decrease during the next year or so, nearly the majority (49 percent) of all respondents in the March 1984 survey expected increased deficits (see Table 2). Just 14 percent of all respondents expected reductions in the

TABLE 2. Expected Reduction in the Federal Budget Deficit During the Next Year or Two (March 1984)

Expected Deficit	All Households
Reduced	14%
Same	29
Increased	49
Don't Know	5
NA	3
Total	100%
Cases	700

The question was: "During the next year or two, do you think the size of the annual budget deficit will be reduced, will the size of the deficit remain about the same, or will the size of the annual budget deficit increase?"

TABLE 3. Expected Change in the Federal Budget Deficit During the Next Five to Ten Years (March 1984)

Expected Federal Budget	All Households
Balanced Budget	20%
Remain in Deficit	73
Don't Know	5
NA	2
Total	100%
Cases	700

The question was: "During the next 5 to 10 years, do you think the federal government will be successful in balancing the budget, or will the federal budget remain in deficit?"

annual federal deficit during the year ahead. Consumers did not expect much progress in the longer term either. Among all families, 73 percent expected that over the next five to ten years the federal budget would remain in deficit. In comparison, 20 percent of all families felt that the government would be successful in eliminating the deficit over the longer term (see Table 3).

Despite this heightened concern, when asked about the impact federal deficits would have on business conditions, the majority (56 percent) in the March 1984 survey reported that deficits would not make any difference, just above the 53 percent recorded in 1982 (see Table 4). The proportion of families that expected budget deficits to worsen economic conditions was 28 percent in the recent survey, down from 33 percent two years earlier.

The relationship between views on the federal deficit and consumer attitudes and expectations is shown in Table 5. Less favorable attitudes and expectations were held by respondents who expressed concern with the current deficit, and by respondents who expected continued deficits in the near and longer terms. In general, these differences were relatively small across a wide array of attitudes and expectations, as indicated by the Index of Consumer Sentiment. The major exception, however, was with regard to interest rate expectations. Much less favorable interest rate expectations were consistently recorded among respondents who voiced concern with the present deficit or expected continued deficits in the future. It appears that current concern with federal deficits has been neutralized due to the limited impact expected on the economy in general. Nonetheless, the major factor likely to translate this latent concern into a manifest concern with the performance of the economy is rising interest rates.

TABLE 4. The Effects of Federal Budget Deficits on Business Conditions

Effects On Business Conditions	April 1982	March 1984
Better	7%	10%
No Difference	53	56
Worse	33	28
Don't Know	5	4
NA	2	2
Total	100%	100%
Cases	702	700

The question was: "Do you think the federal budget deficit expected during the next year will make business conditions in the country as a whole better or worse than at present, or won't it make much difference?"

TABLE 5. The Relationship between Opinions on Federal Deficits and Consumer Attitudes and Expectations (March 1984)

Opinions on Deficits	Index of Consumer Sentiment	Proportion that Expected Increases in Interest Rates
Concern with Budget Deficit		
Very Concerned	100.8	53
A Little Concerned	105.9	39
Not at all Concerned	106.8	29
Expected Deficit Within 1 Year		
Reduced	114.6	31
Same	101.8	38
Increased	99.1	54
Effects of Deficit on Business Conditions		
Better	114.7	34
No Difference	105.4	39
Worse	92.1	62

Summary Outlook

The widespread optimism and confidence recorded in the first quarter survey points toward continued growth in consumer sales during 1984. Reports by consumers that business conditions had improved during the past year were more frequent in early 1984 than at any other time in the prior 30 years. Many fewer consumers, however, expected that same rapid pace of economic improvement to continue during the year ahead. Although consumers expected the rate of improvement to slow, good times financially in the economy as a whole were expected to persist during the next year or so. The financial situation of American families improved substantially by the start of 1984 and, coupled with very favorable perceptions of market buying conditions, has prompted a greater willingness on the part of consumers to make major purchases.

Along with greater sales, these data also indicate that greater pressures on the credit market can be expected in the upcoming months. The length and pace of the recovery will be determined by whether the increases in the demand for credit by the consumer sector, when combined with the needs of the government and the business sectors, can be accommodated without a resurgence in interest rates. Consumer sensitivity to interest rate trends has greatly heightened in recent years, and increases in interest rates are likely to have a pervasive but uneven impact. Consumer purchases of houses and vehicles can be expected to register more immediate and sharper responses than other less interest-sensitive purchases. Interest rate increases will also affect the discretionary incomes of families with outstanding variable-rate loans, as well as families with "variable-rate" checking or savings accounts. Importantly, consumer awareness and concern with federal budget deficits were associated with expected increases in interest rates, and rising interest rates are likely to focus and heighten concerns with federal deficits.

April 1984

Business Economists Foresee Continued Expansion But Urge Action on Deficits

Richard E. Barfield
Survey Research Center
The University of Michigan

The eighth in the series of quarterly surveys of National Association of Business Economists (NABE) members was conducted in early February. Respondents were asked to forecast various economic series and to give their opinions about current economic policy matters. For analytical purposes, the business economists were classified according to their primary affiliation in six groups: manufacturing, nonbank finance, trade associations and others not elsewhere classifiable, government and academic, commercial banking, and consulting.

Conditions in Company/Industry

Throughout the survey program, economists affiliated with a business firm (that is, those in manufacturing, commercial banking, or nonbank finance) have been asked about quarterly trends in various economic aspects of their own company or industry. Results from the February survey are displayed in Table 1 and are generally consistent with the continued economic expansion experienced during the three months preceding the survey:

- Demand was up in about three-quarters of the companies, and employment had been rising or stable for all but about one-eighth. Increases in both demand and employment were most vigorous in manufacturing.
- Inventories had been increasing in only about a quarter of the firms.
- Real capital outlays had been rising in nearly half of the companies and falling in less than 10 percent, with the commercial banking industry having been less likely to see increases than the other two.
- Profit margins had been going up in 40 percent of the firms and stable in 45 percent, with manufacturing firms most likely to have experienced rising profits.
- Prices had remained relatively stable during the period for most firms represented, though in manufacturing nearly half the economists reported increases or decreases.
- Wages and salaries had been rising in slightly fewer than half the firms and stable in slightly more than half, with virtually none reporting falling compensation. About two-thirds of respondents in the nonbank financial area reported rising wage rates and salaries.

These aggregate trends were broadly similar to those reported in the previous (November 1983) survey, with three exceptions: inventory volume was less likely to have been rising in the three months prior to February, real capital outlays were more likely to have been rising, and profit margins were more likely to have been stable.

TABLE 1. Trend in Various Economic Aspects of Respondent's Company or Industry During Three Months Prior to February 1984 Interview

Economic Aspect	Rising	Same	Falling
Unit Volume of Demand	74%	24%	2
Employment	34%	54	12
Unit Volume of Inventories	23%	47	30
Real Capital Outlays	46%	46	8
Profit Margins	40%	45	15
Prices Charged	22%	67	11
Wage Rates & Salaries	45%	52	3

Economic Forecasts

Table 2 displays the median values of forecasts made in February for selected economic series; analogous results from the previous survey are also displayed. Real GNP was expected to increase by somewhat over 4 percent from 1983:4 to 1984:4 and by close to 5 percent for the full year 1984 compared with 1983; both values were a bit lower than those given in the November survey. Consumer prices were forecast to increase by just about 5 percent fourth quarter to fourth quarter and 4.8 percent year over year, with the latter estimate being a bit lower than the one given in November. Real fixed investment was foreseen to increase slightly more than 9½ percent from 1983:4 to 1984:4 and by about 11 percent year over year – both estimates somewhat higher than the ones given in November.

The business economists predicted that the unemployment rate would average close to 8 percent in the third and fourth quarters of this year and for the year as a whole; the latter two estimates were a bit lower than the November ones. The prime rate was expected to remain close to 11 percent through midyear but then to rise to over 11½ percent by year end, somewhat higher figures than forecast in November.

New private housing starts were expected to be stuck at the 1.7 million mark throughout this year, close to the estimates given in November. Auto sales were seen to start the year at about the 10 million unit mark, grow by about a quarter million units by the fourth quarter, and average right at 10 milllion units for the full year 1984. These estimates were also quite close to the November ones.

The only systematic differences in forecasts among the affiliation groups seemed to be that the government and academic economists expected a slightly slower recovery accompanied by higher interest rates: their forecasts of GNP growth, car sales, and fixed investment growth were the lowest of the several affiliation groups, while their prime rate predictions were the highest. Their projections of CPI increase were also the lowest. But the differences among groups were generally quite small this time.

The two regional forecast questions asked first in November were repeated in the February survey, with the business economists being asked whether the "overall economic growth rate" and the unemployment rate in their part of the

TABLE 2. Forecasts of Selected Economic Series, November 1983-February 1984

Series	Median Value Nov. 83	Feb. 84
Annualized Percent Change:		
Real GNP		
1983:4-1984:4	4.88	4.20
Year 1983-Year 1984	5.05	4.80
Consumer Price Index		
1983:4-1984:4	5.05	5.02
Year 1983-Year 1984	5.02	4.84
Real Fixed Investment		
1983:4-1984:4	8.94	9.61
Year 1983-Year 1984	9.13	11.02
Percent:		
Unemployment Rate		
1984:3	—	7.97
1984:4	8.09	7.90
Year 1984	8.29	8.01
Prime Rate		
3/31/84	—	11.05
6/30/84	10.86	11.10
12/31/84	11.20	11.63
Millions of Units:		
New Private Housing Starts		
1984:1	—	1.70
1984:4	1.74	1.70
Year 1984	1.73	1.70
Automobile Sales		
1984:1	—	9.99
1984:4	10.31	10.26
Year 1984	10.04	10.01

Note: Dash indicates quarter forecast not asked for in November.

country would be higher than, lower than, or about the same as the national rate during 1984. Once again the North Central region was expected to be worst off, but the differences weren't as dramatic as those found in November. Concerning real GNP growth, more than half the respondents in the South and West expected faster-than-average change, followed by 43 percent of those in the North Central area and 33 percent of those in the Northeast. But 32 percent of the North Central economists expected slower-than-average growth, compared with 23 percent of those in the Northeast. Somewhat surprisingly, about 32 percent of respondents in the West also expected slower-than-average GNP growth. Concerning unemployment, the expectations were more polarized: about 55 percent of Southern business economists expected lower-than-average local unemployment rates, followed by about 45 percent of those in the West and Northeast; but only 8 percent of economists in the North Central region projected their unemployment rate to average lower than the national rate, while 80 percent saw it as likely to be higher.

Fiscal and Monetary Policy

As in all previous surveys, the business economists were asked about recent fiscal and monetary policy. Trends over the past four surveys in their assessment of the appropriateness of fiscal and monetary policy are displayed in Table 3. As compared with the relatively stable pattern of opinion about fiscal policy during 1983, the February 1984 survey indicated a more nearly unanimous view that fiscal policy then was too stimulative. The proportion of business economists holding that view ranged from 71 percent in nonbank finance to 92 percent in government and academia.

Several other questions relating to fiscal policy were posed in the February survey. Respondents were asked which course of action to reduce prospective deficits they would prefer: reducing expenditures as a proportion of GNP, raising revenues, or some of both. Reducing expenditures was the most popular course, with about two-thirds favoring either expenditure cuts only or expenditure cuts primarily along with some revenue increases. About a fifth of the economists favored taking tax and expenditure actions more or less equally, with only about a tenth emphasizing "revenue enhancement." (But 30 percent of government and academic economists favored the latter course.) When asked whether the administration and Congress should take action to reduce the deficits even though this is an election year, more than 96 percent said yes.

It was noted that the President's Private Sector Commission on Cost Control has issued proposals to reduce federal spending by over $100 billion a year; the business economists were then asked whether the government should move "as rapidly as possible" to implement these proposals. Ninety percent said at least some of the proposals should be implemented, though about a quarter of the goverment/academic economists disagreed. Survey participants were asked their opinion about limiting the rate of indexation of income tax brackets and cost of living adjustments of entitlements programs (including Social Security) to "the rate of inflation less three percent." Some two-thirds favored enactment of such a limitation. Finally, the economists were asked whether the president should have line-item veto powers. Almost three-fourths favored the idea, though those affiliated with goverment and academia split 50-50.

TABLE 3. Trends in Opinions about Fiscal and Monetary Policy, May 1983-February 1984

Opinion	May	August	November	February
Fiscal Policy:				
Too Stimulative	73%	76%	73%	82%
About Right	21	20	22	14
Too Restrictive	7	4	5	4
Monetary Policy:				
Too Stimulative	26%	23%	3%	3%
About Right	67	69	82	78
Too Restrictive	7	8	15	19

The questions were "What is your view about current fiscal policy – is it too stimulative, too restrictive, or about right?" and "What is your view about recent monetary policy actions – have they been too stimulative, too restrictive, or about right?"

Concerning recent monetary policy, the February survey revealed little change in opinion from the November survey, with around 80 percent viewing it as about right and most of the remainder seeing it as too restrictive. As noted in our previous report, this does represent a shift away from the "too stimulative" view when compared with opinion earlier in 1983.

Other Issues

As in other surveys, the business economists were asked several questions about the international economy. When asked whether the quota on auto imports from Japan should be allowed to expire on schedule in March 1985, nearly 85 percent said yes (but only about 70 percent of those in manufacturing agreed). Opinion was nearly unanimously against the House-passed legislation requiring up to 90 percent of any car sold in the U.S. to be made domestically, and there was little variation among the various affiliation groups here. Another question in this area—repeated from August and November of last year--asked for the change expected in the international value of the dollar, "calculated on a trade-weighted basis," between the survey date and the end of the year. Only one-tenth each expected an increase or no change, with the remaining 80 percent anticipating at least some decrease. This balance of opinion continues the shift noted last year toward an expectation that the dollar's value will decline, though of course the time horizon was substantially longer when the question was posed in February than when it was posed in August or November 1983.

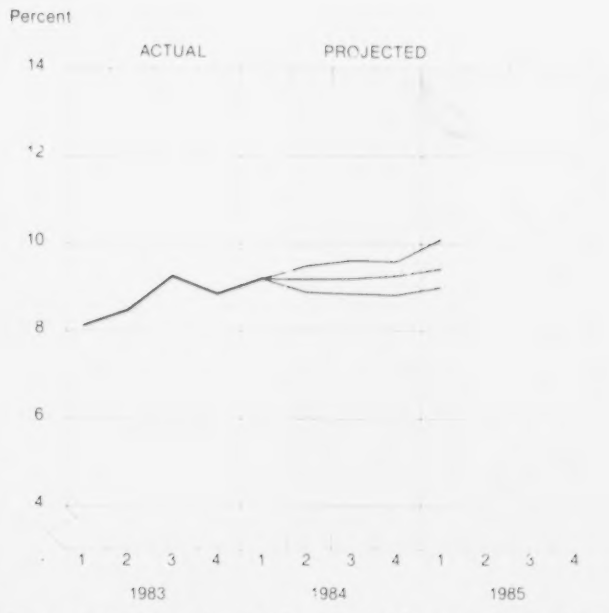
Finally—as in the November survey—NABE members were asked "in which year do you expect the peak of the current [business] cycle to occur?" Answers are displayed in Table 4 and are distributed by the six primary affiliation categories. Again the modal year expected to mark the end of the current expansion turned out to be 1985, with nearly a sixth of the business economists seeing an end this year. Consulting economists and their government/academic colleagues appeared rather less optimistic than other survey participants that the expansion would last beyond 1985. Hardly anyone in the sample (about 4 percent) expected the current expansion to last beyond 1986. As noted in our last report, if this expectation is fulfilled, the current expansion will then have been somewhat shorter than the average postwar business cycle expansion.

TABLE 4. Expected Year for Peak of Current Business Cycle by Primary Affiliation of Business Economists, February 1984

	Primary Affiliation Group						
Year	Manufacturing	Nonbank Finance	Trade Associations & "Other"	Government & Academic	Commercial Banking	Consulting	All Groups
1984 or Earlier	16%	15%	15%	23%	9%	21%	16%
1985	47	50	52	54	55	65	53
1986	35	30	28	19	29	14	27
1987 or Later	2	5	5	4	7	0	4

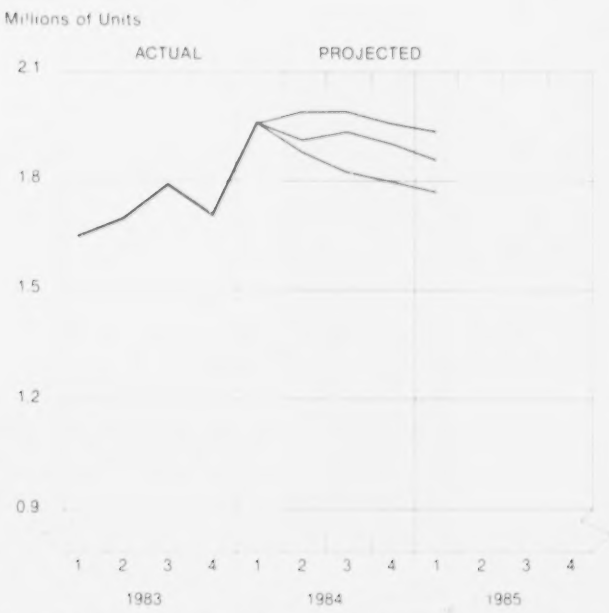
The question was "Most economists agree that the business cycle is still very much with us. Assuming that's the case, in what year do you expect the peak of the current cycle to occur?"

3-MONTH TREASURY BILL RATE



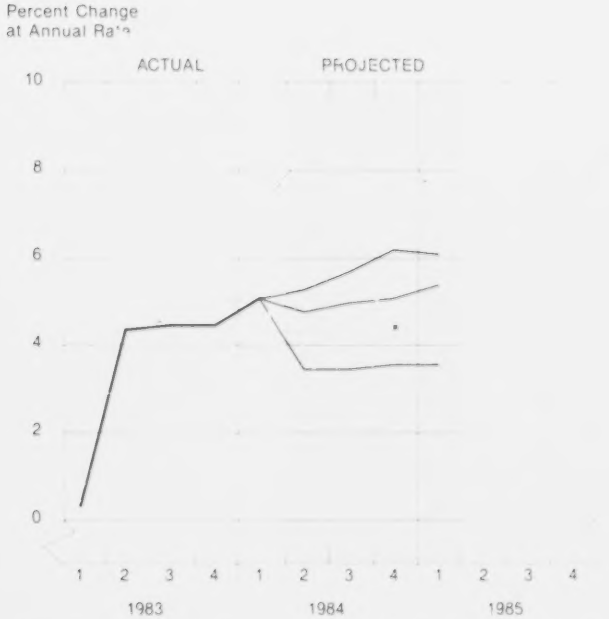
Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

NEW PRIVATE HOUSING UNITS STARTED



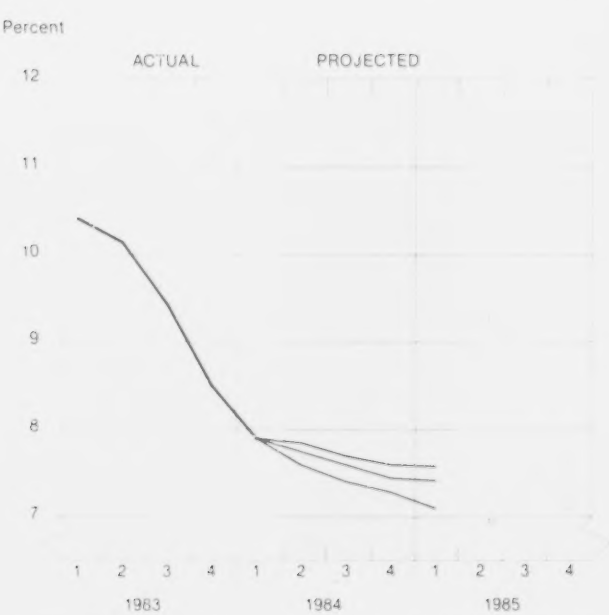
Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

CONSUMER PRICE INDEX



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

UNEMPLOYMENT RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

The Changing American Family: Marriage and Divorce*

Arland Thornton
Survey Research Center
Deborah Freedman
Department of Economics
The University of Michigan

Some of the issues most fiercely contested in the American public arena during the past decade have focused directly on central aspects of the family. The battle over the Equal Rights Amendment concerned appropriate roles for men and women and the allocation of opportunities and rewards by gender. The abortion controversy bears directly on the reproductive function of the family, while the debate over sex education in schools and birth control for minors involves not only teenage sexual activity and childbearing but also the right of public organizations to intervene in relationships between parents and children. Important elements in these controversies concern the relative roles of public and familial supports for individual Americans and the extent to which governments should influence familial matters.

This surge of interest in family issues mirrors the magnitude of the changes occurring in family values and behavior. Although the family continues to be a central institution in American society, the shape of the institution is changing in ways that are influencing most Americans. Consider the following:

- Fifty-six percent of women aged 20-24 in 1983 have never been married, compared to only 36 percent of women this age in 1970.
- The number of unmarried couples living together has more than tripled since 1970 to nearly 1.9 million in 1983.
- Half of all recent first marriages will end in divorce if current rates continue, and up to half of all children will experience living in a fatherless family before they reach age 18.
- Currently, 19 percent of households with children under 18 are headed by a woman with no husband present.
- Over half (51 percent in 1982) of all married women now hold a paid job outside the home, including 49 percent of married mothers of preschool children.
- Median income for married-couple families with a working wife was $30,300 in 1982, compared to $21,300 where only the husband worked.
- Young white women now in the prime childbearing ages of the twenties say they expect to have an average of two children but are delaying the start of their families to such an extent that nearly 30 percent of them could end up childless.
- Eighteen percent of all births in 1980 were out of wedlock.

These trends affecting family patterns have had major repercussions on many aspects of American life, ranging from changes in divorce laws and marital settlements to the new political force of the women's vote and a proliferation of new products and advertising strategies aimed at two-earner families. The impact of family changes on individuals is demonstrated by the growth of organizations designed for people living in non-traditional family situations—the National Association of Step Parents, Mothers Without Custody, Equal Rights for Fathers, Parents Without Partners, and Fathers Who Care. A stream of new books provides advice on surviving divorce, combining motherhood and a career, being a successful stepparent, and being a single adult. The changes seem so great that many Americans have begun to wonder if the very institution of the family will survive. Our studies indicate, however, that the family is resilient, family ties remain strong, and Americans consistently report that a happy marriage and a good family are the most important aspects of life.

In this article we focus on past and current trends in marriage and divorce in the United States, derived from data collected here at the Survey Research Center and elsewhere. Future articles in ECONOMIC OUTLOOK USA will discuss other aspects of change in the American family.

Marriage and Divorce

In the United States, marriage has traditionally marked the creation of a new family. Typically, families have been formed when previously unmarried persons join together in marriage. Marriages, however, do not last forever and eventually are dissolved, either by the death of a spouse or voluntarily through divorce. Important for the institution of the family is how long marriages last, on average, until dissolved, and whether the most frequent cause is death or divorce. Marital dissolution, however, does not signal the end of the marital experience for many former partners. Most formerly married Americans enter into a new marriage fairly quickly, thus revealing a preference for the married state. Recently another type of arrangement has become more common—couples living together without getting married.

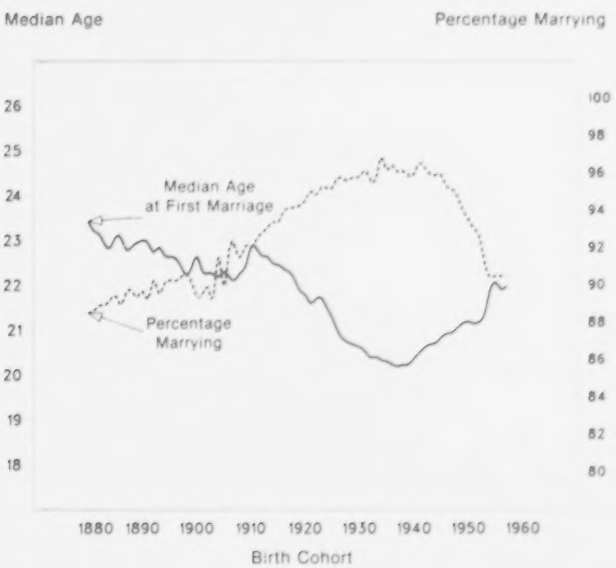
First Marriage

First marriage patterns have gone through a wave of change since World War II. Except for a brief upturn at the end of World War I and a sharp decline during the Depression of the 1930s, first marriage rates were quite steady during the first four decades of this century. But after World War II came the "postwar marriage boom"—a substantial, pervasive increase in marriage rates that helped spawn the baby boom. The rates remained high through the 1950s and 1960s and then fell sharply again during the 1970s and now have begun to stabilize at levels very similar to those of the first few decades of the century.

Chart 1 shows how the postwar marriage boom reshaped the pattern of first marriage in America. Median age at first marriage fell dramatically—from about 23 for white women born in the 1880s to just over 20 for those born in the late 1930s, who married in the late 1950s and early 1960s. The proportion of people ever marrying also increased. While

*This article is taken from the authors' "The Changing American Family," *Population Bulletin*, Vol. 38, No. 4 (Population Reference Bureau, Inc.: Washington, D.C., 1983) and is published here with the permission of the Population Reference Bureau, Inc. Complete references for the material cited herein are contained in the *Population Bulletin* monograph.

CHART 1. Median Age at First Marriage and Percentage Marrying through Age 44, Birth Cohorts of White Women



about 11 percent of white women born during the 1880s had not married by age 45, only about 3 percent of those born in the late 1930s remained single at that age. However, the marital patterns of more recent "birth cohorts" are close to those observed early in the century. Median age at marriage for white women born during the 1950s has increased to around 22, and it now appears that about 10 per cent, and possibly more, will never marry. In 1983, 56 percent of all American women aged 20-24 still had not married, compared to just 36 percent of women that age in 1970.

The marriage boom was both more substantial and longer-lasting for men than for women. While the average age at marriage fell about three years for women, the decline was about four years for men—from about age 27 to 23. In addition, marriage rates for women declined somewhat during the 1960s but the rates for men held fairly steady. This can probably be attributed to the "marriage squeeze"—a phenomenon caused by a shortage of men relative to the number of women in the prime marrying years. The shortage resulted because the number of babies born each year as the baby boom mounted from 1947 was larger than the number born the year before, and women tend to marry men two to three years older than themselves. Thus, there was an insufficient number of older men from which the women in each of these successively larger birth cohorts could choose their mates.

Prior to World War II, similar proportions of blacks and whites married, but blacks tended to marry at earlier ages. However, the postwar marriage boom was not as marked for blacks as for whites, especially at the younger ages, and average age at first marriage is now higher for blacks than for whites.

The timing of marriage relative to school attendance and employment also changed markedly after World War II. Previously, the transition to adulthood had been made in a fairly regular and orderly fashion; most men and women finished their schooling and most men began to work before marrying. But after the war many young people chose to marry while still in school and before beginning work.

Part of this shift was linked to the postwar expansion of education, which increased educational attainment and thus the age of school completion. Although educational opportunities and attainment had expanded somewhat before the war, still in 1940 only 36 percent of men and 40 percent of women aged 25-29 had completed four years of high school, and just 7 percent of men and 5 percent of women had completed four years of college. By 1979, 85 percent of both men and women in this age group had completed high school, and one-fourth of men and one-fifth of women had completed college. This increase in educational attainment added to the decline in age at marriage in the postwar era meant that many more people married before finishing their education; nearly a fourth of the men born during the 1930s did so, compared to less than a tenth of those born two decades earlier. With age at marriage now rising, this trend has been reversed, but there is unlikely to be a return to the prewar pattern of nearly universal postponement of marriage until after school completion, unless age at marriage increases enough to offset the current high levels of education.

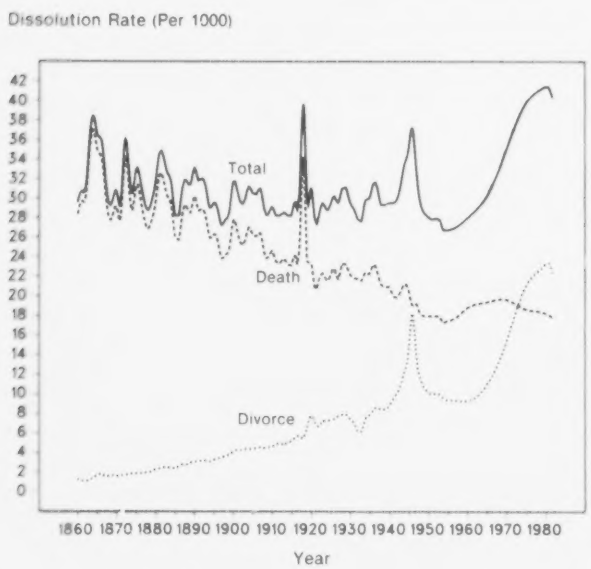
Attitudes toward marriage and remaining single have changed markedly along with the changes in marital patterns. The legitimacy of remaining single is increasingly accepted by both young people and their parents; Americans no longer regard getting married as necessarily better than remaining single. A 1976 national study found that only a third of all Americans would disapprove of a decision by someone to remain single—a decline from 50 percent in 1957. Although most young people now say that they would be bothered at least a little if they did not marry, only a few say they would be greatly bothered by that outcome. Mothers also report that they would not be greatly bothered if their children did not marry.

Although the imperative to marry has weakened, marriage continues to be highly valued by Americans. Americans consistently report that a happy marriage and a good family life are the most important aspects of life. Most young Americans still expect to marry; a 1980 study found that more than 90 percent of American youth expect to marry—a proportion similar to that found in 1960. Most young Americans are also optimistic about the permanency of their marriages. However, marital plans have changed to parallel the increases in actual marriage ages; between 1960 and 1980 the median age at which young people expect to marry increased by a year for men and year and a half for women. Even though most young Americans value marriage and plan to marry, the fact that they accept the legitimacy of single life and plan to postpone their own marriages may result in an increase in the percentage who never marry.

Divorce

Marital conflict and divorce have been recognized as serious social concerns since as far back as the late 18th century. But, while marital incompatability has always been with us, Chart 2 shows that, except for a sharp but temporary increase after World War II, the actual rate of divorce in the United States increased only gradually and steadily, with some minor fluctuations, from 1860 to the early 1960s. Then came two decades of sustained and rapid increase, with the rate more than doubling, so that by the

CHART 2. Marital Dissolutions Per 1000 Existing Marriages by Divorce, Death, and Total



end of the 1970s more than 2 percent of existing marriages were being terminated by divorce each year. Then the rate leveled off and there was even a slight decline in 1982. Actual *numbers* of annual divorces climbed to a record 1.21 million in 1981 and then also dipped 3 percent to 1.18 million in 1982—the first decline since 1962.

The forces behind the surge in divorce during the 1960s and 1970s were not only strong but also pervasive, affecting all races and age groups about the same. Thus, the divorce differentials observed in the 1950s—less divorce among whites than among blacks and less among older persons and those married at later ages—persisted through the 1970s.

The rapid increase in divorce has meant that, while 29 percent of the couples married in 1952 were divorced by their 25th wedding anniversary, couples married in 1957 took only 20 years to experience a similar attrition, those married in 1962 took only 15 years, and those married in 1967 took only about ten years. Almost half of the marriages of 1973 will end in divorce if the divorce rates of 1977 continue, compared to only about 5 percent of the marriages of the 1860s. For black Americans the current proportion is even higher; as many as two-thirds of all recent marriages of black Americans could be terminated by divorce if current rates continue. Black couples are also much more likely to separate than white married couples.

Of course, marriages are also terminated when one spouse dies. From 1860 through the mid-1960s, the increasing divorce rate was generally offset by the declining death rate. Consequently, except for unusual fluctuations in mortality and divorce, the total marital dissolution rate remained roughly constant or even declined somewhat over this century (Chart 2). During the 1960s and 1970s, however, the rapid increase in divorce outstripped the decline in mortality, resulting in a substantial increase in the total marital dissolution rate.

Children of Divorce

One of the most serious consequences of the high divorce rate is its effect on the lives of children. Over a million children are affected by divorce each year in the United States. The 1.2 million children whose parents were divorced in 1979 represented nearly 2 percent of all children under age 18. The exposure of children to marital disruption is not a recent phenomenon, however. Some 25 to 30 percent of all children born during the first half of this century experienced the disruption of their parents' marriage before they reached age 18, with the main reason shifting over time from mortality to separation and divorce. However, the marked rise in divorce during the 1960s and 1970s has increased the total exposure of children to family dissolution. Dissolution rates of the late 1970s imply that about one of every three white children and two of three black children born after marriage will experience a parental marital dissolution by age 16. Most children of divorced parents live with their mother, and the majority will experience living in a fatherless home for at least five years. Furthermore, this experience is not necessarily ended when the mother remarries; approximately one-third of white and one-half of black children whose mothers remarry will experience a second parental marital dissolution before they reach adulthood.

Reasons for the High Divorce Rate

It would be easy to interpret the increase in divorce as a sign of deteriorating family life and declining marital happiness, but there are other possible reasons: people may now expect more of marriage and thus be more aware and less tolerant of their marital problems; Americans may now be more accepting of divorce as a solution to an unhappy marriage; and changes in laws and economic circumstances have made divorce more feasible. One study suggests that marital happiness has actually increased; the proportion of people saying that their marriage was either very happy or above average went up from 68 percent in 1957 to 80 percent in 1976. While this finding probably partly reflects the fact that more unhappy marriages were terminated by divorce during the 1970s than in the 1950s, it also raises doubts about a general decline in marital happiness.

The same study also showed that the proportion of people perceiving problems in their marriage increased at the same time—from 46 percent in 1957 to 61 percent in 1976. But this probably reflects not so much an increase in marital problems as the greater expectations for marriage which now make people less tolerant of ordinary difficulties in their own marriages.

Generally negative attitudes toward divorce have been declining as Americans have become more willing to see it as a solution in specific cases. The extent of this shift is illustrated by a study in which 82 percent of women interviewed in 1980 disagreed with the statement: "When there are children in the family, parents should stay together even if they don't get along"; only 51 percent of these same women disagreed with this in 1962. Preferences for easier divorce laws have also increased recently. Of course, this apparently greater acceptance of divorce could be more a consequence than a cause of increasing divorce.

The increase in women's labor force participation and decline in family size probably have made it easier for Americans today, especially women, to obtain a divorce. Changes in marital laws have also facilitated divorce. In fact, the spiraling divorce rate has been a major contributor to the veritable revolution in family law. The first no-fault divorce law was passed in 1969 in California, and by 1980 all but Illinois and South Dakota had adopted some form of no-fault divorce. This has made moral issues less relevant in divorce litigation, while property division and child custody rights have become the important concerns. At the same time, the incidence of family litigation has exploded; roughly half the cases on civil court dockets are family law cases, largely a result of the higher divorce rate.

For divorced women, financial problems loom large. The payment of alimony (now generally called "spousal maintenance") has never been common. Alimony now is probably awarded only rarely, and then primarily to help the wife temporarily until she can get a job. On the other hand, judicial rulings regarding the division of marital property have become more equitable for women. Until very recently, all but the few "community property" states followed English common law and awarded property in a divorce to the person whose name appeared on the title, usually the husband. Now most states have adopted more equitable distribution laws for divorce settlements, with the definition of equitable sometimes spelled out as equal, but more often left to judicial decision. The definition of marital property remains in flux; pension benefits, medical benefits, seniority rights, and military pensions have been included. Still controversial and currently the subject of litigation is whether the value of profesional degrees and careers can be quantified and included in marital settlements. Judges still award child-support payments, but in 1982 only 69 percent of white women and 34 percent of black women who had minor children from an absent father had been awarded or had an agreement to receive such payments.

Despite legal shifts toward more equitable property settlements, wives typically find themselves financially much worse off than their former spouse after a divorce. The family assets to be divided are not large in many marriages. No-fault divorce laws have restricted wives in more prosperous families from bargaining for a favorable financial settlement in exchange for an uncontested divorce. Child-support awards, while important for divorced mothers, often are not large and frequently are not paid. In 1981, only 75 percent of divorced and separated women due child-support payments actually received any and the average payment for the year was about $2,300. Only about half of payments are ever made in full, and for women whose marriages have been terminated for several years the payment rate is even lower. Collecting delinquent payments is expensive, time-consuming, and difficult for divorced mothers. Federal and state governments now have programs to enforce child-support decisions, but they provide only marginal relief to divorced women. Meanwhile, in job markets still generally tilted against women, many divorced women have trouble finding a job that pays enough to support a family, especially those who have been out of the labor force for some time. With all this, divorce now constitutes a major cause of poverty among women and their children.

Judicial decisions regarding child custody have also changed. Until the middle of the 19th century, children automatically went to their fathers, but as economic conditions changed, the laws were modified to award custody to mothers as the natural nurturers of children during their "tender years." In most states, judges now make custody decisions on the basis of the child's best interest. Mothers still obtain custody in about nine out of ten cases, but fathers more often seek custody, and joint custody—now legal in 28 states—is an option viewed more favorably by many judges. Meanwhile, litigation over custody and visitation rights has increased greatly. Grandparents also now go to court to obtain the right to visit with their grandchildren.

Remarriage

Most family scholars believe that divorce stems from dissatisfaction with a specific spouse and does not represent disillusionment with marriage as an institution. Most divorced people remarry, so the remarriage rate following divorce has been very high in the United States—generally exceeding the first marriage rate. Many of these remarriages occur fairly soon after divorce; for example, about half of all women who divorce while still relatively young remarry within three years and from 60 to 70 percent remarry within five years. Men, however, are more likely than women to remarry eventually after divorce, and remarriage rates are also higher for younger than for older divorced people.

Remarriage rates for black Americans are considerably lower than those for whites. One national study of young ever-separated women found that two-thirds of the white women had remarried by the interview in 1970, but only about one-third of the black women. This disparity reflects the fact that blacks are both more likely than whites to remain separated without divorcing and less likely than whites to remarry after a divorce.

By 1977, 43 percent of all new marriages were remarriages for one or both of the partners, up from 32 percent of marriages in 1969; and in 1980, 20 percent of all existing marriages included at least one previously divorced spouse. Many of these remarriages involve people who have been married at least twice before.

In earlier times, remarriages usually involved people whose former spouse had died. These families were complex, often including stepparents and stepchildren and siblings related only through marriage or who shared only one biological parent. Now remarried families have become both much more numerous and more complicated because most remarriages involve divorced persons whose former spouses are still alive and living elsewhere, often with children from that marriage. A recent study estimated that in at least 40 percent of remarriages with partners in their thirties, one of the partners, usually the husband, has a child from a previous marriage who is living elsewhere. In these cases a central family relationship—that between parent and child—is split across at least two households.

Remarried families often maintain relationships with the former spouse and his or her family. These can become especially complicated when both spouses in a remarriage have been divorced before, perhaps more than once, and have children from the previous marriage, and when former spouses also remarry. Of course, the new configurations created by divorce and remarriage can be a source of additional support and family interaction. But they add family responsibilities as well and can bring new conflicts and tensions, particularly for children, who are the chief links between former spouses and their current families. How can consistent guidelines for discipline be maintained when parents share custody or when the children in a household

have differing relationships to the parents who maintain the household? What can a stepmother do to win acceptance from her new spouse's children? How should children relate to their enlarged group of siblings and other new "step-relatives"? Such complexities probably help explain why divorce rates among remarriages are as high as or higher than the rates for first marriages.

Remarriage has generally followed the trend in first marriage, with a substantial rise after World War II. Unlike first-marriage rates, however, remarriage rates continued to rise during the 1960s, in tandem with the surge in newly divorced young people—the group most likely to remarry. Remarriage rates computed separately for divorced and widowed women remained fairly steady through the 1960s and then, like first-marriage rates, dropped sharply during the mid-1970s and seemed to have stabilized at the end of the decade. This leveling off might be expected to continue in the 1980s with the divorce rate now also apparently stabilized. Even so, the number of people remarrying fairly soon after divorce remains high.

The Unmarrieds

With reduced rates of first marriage and remarriage combined with high divorce rates, the percentage of currently single adults has increased markedly. In 1982, only 39 percent of women aged 20-24 were currently married and living with their husbands, compared to 64 percent of women this age in 1960. Single life is now particularly common for black adult Americans. Among women aged 30-54 in 1982, less than half of black women were married and living with their husbands, compared to more than three-fourths of white women.

This growing market of unmarrieds is now a prime target for businesses and organizations. Community agencies organize social activities especially for singles, commercial firms promote dating services, and many businesses have designed products, services, and new marketing techniques to cater to the special needs of the new unmarried group, including a proliferation of new books, magazines, and newspapers offering advice on how to enjoy and manage single living.

Cohabitation without Marriage

The number of unmarried American adults sharing a household with an unrelated person of the opposite sex more than tripled between 1970 and 1977 and nearly doubled again in the five years from 1977 to 1982. Though the rise tapered off in the next year, still, in March 1983, close to 1.9 million couples—4 percent of all couples maintaining a separate household—were living together without benefit of matrimony, up from about half a million in 1970. This increase in cohabitation can be attributed both to the larger number of unmarried people in the population—the result of declining marriage rates and increasing divorce rates—and their greater tendency to live together without marriage. Cohabitation has increased among persons of all ages and marital statuses, but particularly among the young and the divorced. By 1983, eight of every ten unmarried-couple households were maintained by a person under 45, and 28 percent included at least one child under 15.

The figures on current cohabitation considerably understate the percentage of young persons who will cohabit at some time during their lives. Eighteen percent of a 1974-75 sample of men in their twenties said they had lived with a woman without marriage for six months or more, even though only 5 percent were currently cohabiting. By now, the percentage of men with some experience of cohabitation must be much higher, paralleling the rise in current cohabitation.

There is little to document the extent to which cohabiting partners view living together as a prelude to marrige, an alternative to marriage, or simply a more economical and enjoyable form of independent living. Thus, it is difficult to assess the effect of cohabitation on marriage rates. The decline in marriage and rise in cohabitation are clearly linked, but which causes the other remains uncertain. Some cohabiting couples probably would have chosen marriage during earlier times. One study has shown that at least one-fourth of the drop in the percentage of ever-married persons between 1970 and 1977 was due to rising cohabitation. However, it is still not clear whether cohabitation has increased because more people are delaying marriage or because the new popularity and acceptability of cohabitation encourage couples to choose it in lieu of marriage.

Errata: The shaded areas indicating recession periods were incorrectly placed for several charts in the Winter 1984 issue. Affected charts are all those on pages 21-23 and the Index of Consumer Sentiment chart on page 14. The shaded areas all should have been placed one year to the left of (or, one year earlier than) their printed position. For example, the most recent recession occurred from mid-1981 to the end of 1982, rather than mid-1982 to the end of 1983, as shown. And, the shaded area indicating projected quarterly data for the table on page 20 (Actual and Projected Economic Indicators) was extended one quarter too far to the left (to cover actual data for 1983:4). We regret these errors and have implemented new procedures to prevent them.

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL

ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual						Projected						Act'l.	Projected	
	1982:3	1982:4	1983:1	1983:2	1983:3	1983:4	1984:1	1984:1	1984:2	1984:3	1984:4	1985:1	1983	1984	1985
GROSS NATIONAL PRODUCT	3,091	3,110	3,172	3,272	3,362	3,436	3,541	3,519	3,595	3,673	3,753	3,834	3,310	3,635	3,961
GNP IMPLICIT PRICE DEFLATOR (index, 1972 = 100)	208.0	210.0	212.8	214.6	216.4	218.5	220.7	221.0	223.5	226.0	229.0	232.0	215.6	225.0	236.5
CORPORATE PROFITS AFTER TAXES	116.5	113.5	108.2	127.2	144.1	142.9	NA	148.0	152.5	157.2	162.4	165.0	130.6	154.2	167.8
UNEMPLOYMENT RATE (percent)	10.00	10.60	10.37	10.10	9.40	8.47	7.87	8.00	7.85	7.70	7.55	7.52	9.58	7.80	7.50
INDUSTRIAL PRODUCTION (index, 1967 = 100)	138.2	135.3	138.5	144.5	151.8	155.5	159.7	159.0	161.0	163.0	165.0	166.3	147.6	162.0	169.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.116	1.269	1.643	1.690	1.782	1.699	1.950	1.720	1.730	1.750	1.720	1.680	1.704	1.745	1.610
CONSUMER PRICE INDEX (% change from prior quarter or year)	7.2	1.6	0.3	4.3	4.2	4.4	5.0	4.2	4.3	4.5	4.6	4.9	3.2	4.5	5.1
3-MONTH TREASURY BILL RATE (%)	9.71	7.94	8.08	8.42	9.19	8.79	9.13	8.90	8.90	8.90	8.96	9.10	8.62	8.90	9.03
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	14.72	12.22	11.99	11.57	12.68	12.76	NA	12.68	12.80	12.70	12.65	12.80	12.25	12.80	13.00
GNP IN 1972 DOLLARS	1,486	1,481	1,490	1,525	1,553	1,573	1,604	1,590	1,607	1,623	1,637	1,651	1,535	1,614	1,666
PERSONAL CONSUMPTION EXPENDITURES (1972 $)	971	980	987	1,011	1,016	1,032	1,047	1,043	1,053	1,062	1,070	1,078	1,011	1,057	1,090
NONRESIDENTIAL FIXED INVESTMENT (1972 $)	163.3	160.5	159.9	163.0	170.1	180.7	185.9	182.0	184.2	187.4	191.0	194.0	168.4	186.0	197.9
RESIDENTIAL FIXED INVESTMENT (1972 $)	36.5	40.6	45.5	52.6	56.8	55.8	59.7	57.0	58.0	59.0	59.0	59.0	52.7	58.0	57.0
CHANGE IN BUSINESS INVENTORIES (1972 $)	- 1.3	- 22.7	- 15.4	- 5.4	3.8	8.7	26.6	10.0	10.0	11.7	13.0	13.5	- 2.1	11.6	13.3
NET EXPORTS (1972 $)	24.0	23.0	20.5	12.3	11.4	2.8	- 6.5	1.9	1.4	0.5	0.5	1.8	11.8	0.5	3.0
FEDERAL GOVERNMENT PURCHASES (1972 $)	116.9	124.4	118.4	117.6	118.9	116.4	114.4	118.4	121.6	124.7	127.0	128.0	117.8	123.5	130.0
STATE AND LOCAL GOVERNMENT PURCHASES (1972 $)	175.3	175.2	174.5	174.5	176.3	175.9	177.3	177.0	178.0	179.0	180.0	181.0	175.3	179.0	182.0

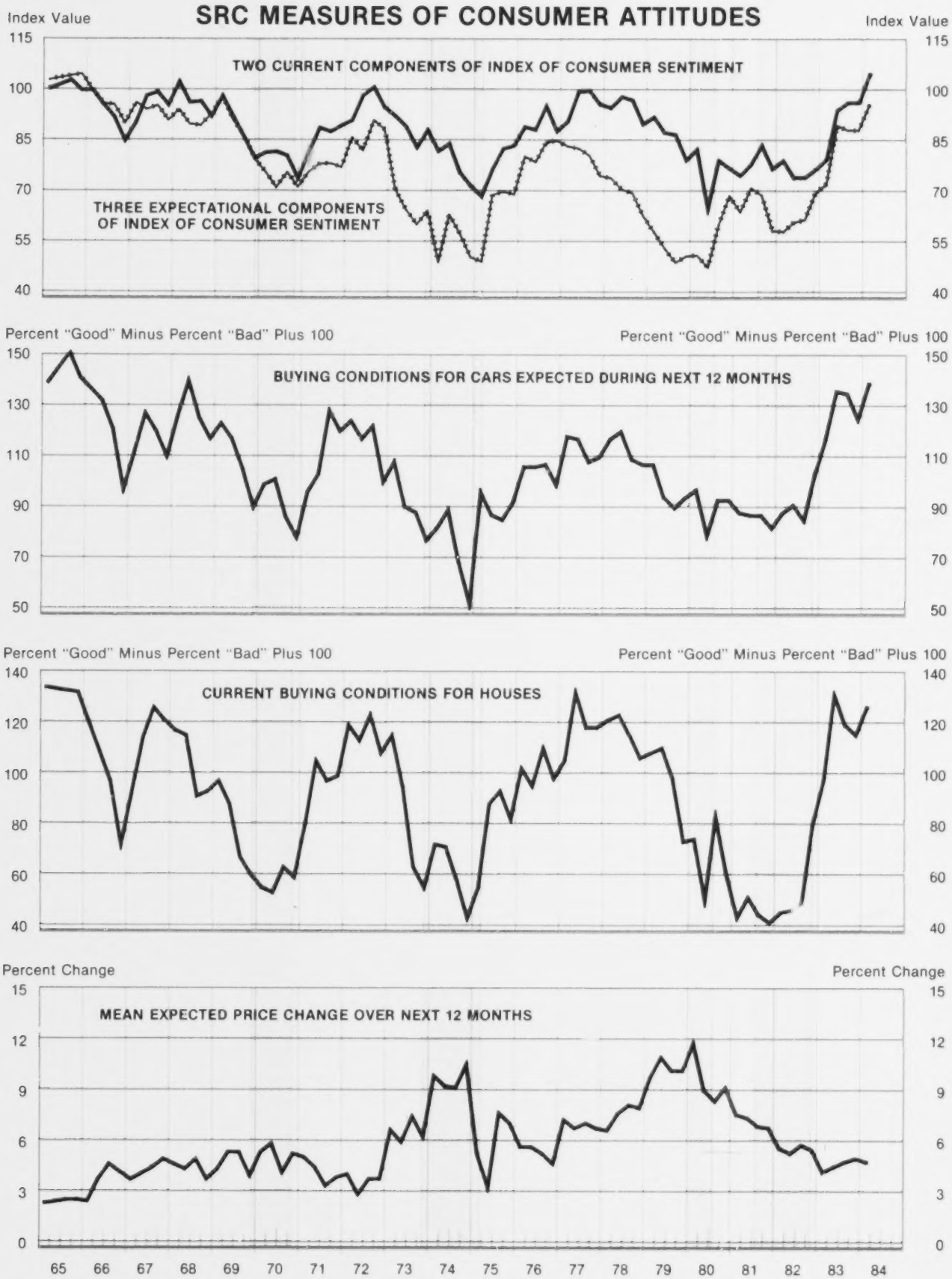
SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS

ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1981:2	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1983:3	1983:4	1984:1	1981	1982	1983
GROSS NATIONAL PRODUCT	2,913	3,005	3,032	3,021	3,070	3,091	3,110	3,172	3,272	3,362	3,436	3,541	2,954	3,073	3,310
PERSONAL CONSUMPTION EXPENDITURES	1,836	1,886	1,904	1,939	1,973	2,009	2,047	2,073	2,147	2,181	2,231	2,280	1,857	1,992	2,158
GROSS PRIVATE DOMESTIC INVESTMENT	472.1	495.8	476.2	422.9	432.5	425.3	377.4	404.1	450.1	501.1	532.5	595.3	474.9	414.5	472.0
NET EXPORTS	21.1	22.8	29.2	29.9	33.3	0.9	5.6	17.0	- 8.5	- 18.3	- 26.1	- 45.2	26.3	17.4	- 9.0
GOVERNMENT PURCHASES	583.5	600.3	622.8	629.8	631.6	655.7	679.7	677.4	683.4	698.3	699.0	710.6	595.7	649.2	689.5
DISPOSABLE PERSONAL INCOME	2,010	2,092	2,121	2,128	2,159	2,192	2,228	2,256	2,301	2,362	2,424	2,503	2,048	2,177	2,336
PERSONAL SAVING RATE (% of disposable income)	6.0	7.2	7.5	6.1	5.9	5.6	5.4	5.4	4.0	4.9	5.2	6.1	6.6	5.8	4.9

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late April, and projected data, released by ASA-NBER in March, are displayed for first quarter 1984.

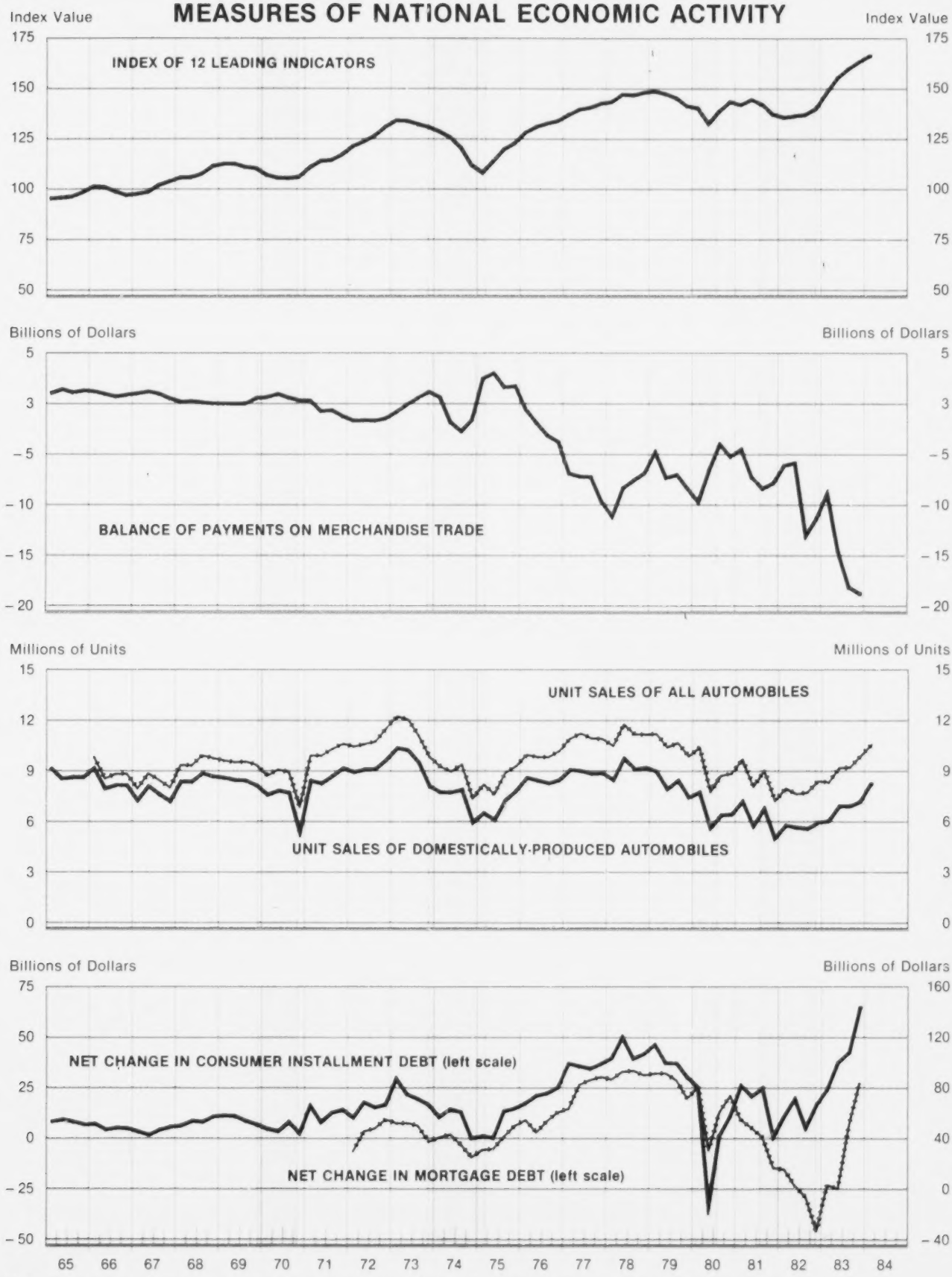
Sources: Projections: American Statistical Association – National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

SRC MEASURES OF CONSUMER ATTITUDES



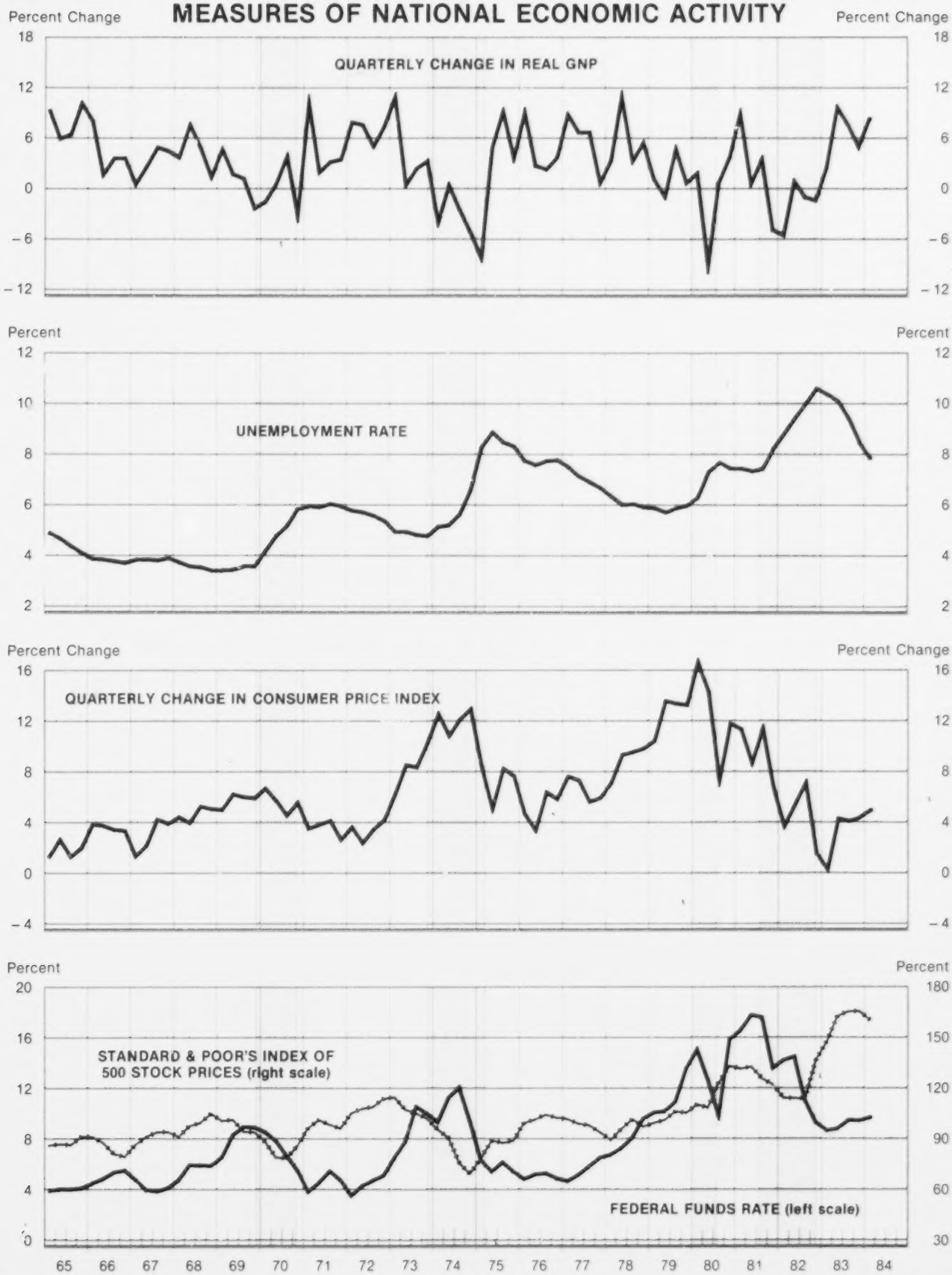
Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



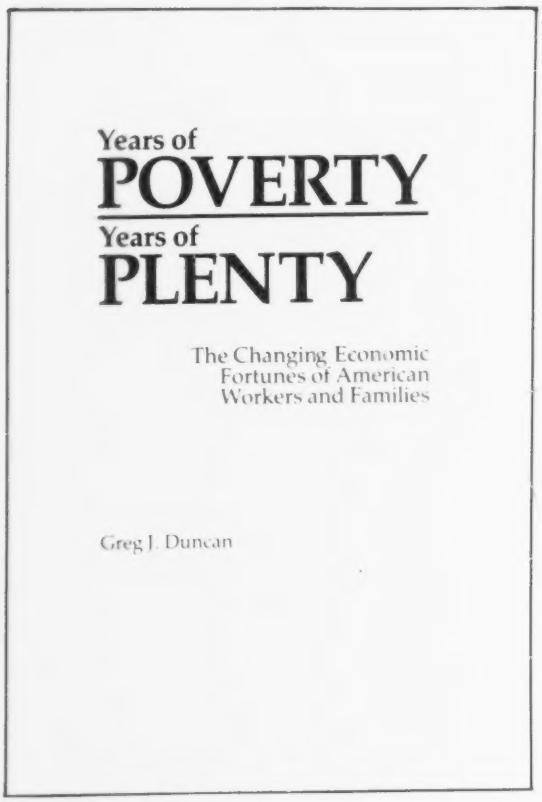
Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Sheds new light on welfare use and family economics in America...



This volume explores the economic ups and downs experienced by a large and representative sample of American families from 1969 through 1978. Author Greg J. Duncan—along with colleagues Richard D. Coe, Mary E. Corcoran, Martha S. Hill, Saul D. Hoffman, and James N. Morgan—has distilled ten years of economic, behavioral, and attitudinal data from ISR's ongoing Panel Study of Income Dynamics.

This long-term perspective on families reveals some previously unobserved patterns in American life, contradicting much of what has been inferred from cross-sectional survey information about the causes and extent of change in family economic well-being. The data reveal that American households actually undergo an astonishing amount of change in terms of family composition, occupations, income levels, and labor force participation.

The researchers found that welfare touches may lives: One in every four Americans lived in a family that received welfare during at least one of the ten years studied. But the findings also showed that there is substantial turnover among the poverty population, contradicting the popular notion that poverty tends to be an inescapable, self-perpetuating condition.

Exploring the dynamics of poverty and welfare use, the researchers found that changes in family composition are crucial explanatory factors, with divorce or separation imposing a devastating economic cost in the impoverishment of women and their children.

Other major findings include an assessment of changes in the economic status of black working men over the past two decades, and an examination of the unchanging wage gap between working women and their male counterparts.

The results and conclusions from these unique data have important implications for social science theory and for the social and economic policies that are based on that theory.

Contents

- An Overview of Family Economic Mobility
- Dynamics of Poverty
- Dynamics of Welfare Use
- Dynamics of Work Hours, Unemployment, and Earnings
- Recent Trends in the Relative Earnings of Black Men
- Do Women "Deserve" to Earn Less Than Men?
- References
- Glossary/Index

1984 / 200 pages / ISBN 0-87944-285-9 / cloth $24

Order from: ISR Publications Sales
Institute for Social Research
The University of Michigan
P.O. Box 1248
Ann Arbor, MI 48106-1248

All orders from individuals must be prepaid.

ECONOMIC OUTLOOK USA
SRC—P.O. Box 1248
Ann Arbor, MI 48106

9/20/84 U7475-3 A

ECONOMIC OUTLOOK USA

SUMMER 1984
Vol. 11 No. 3

A quarterly publication of the
SURVEY RESEARCH CENTER
Institute for Social Research
THE UNIVERSITY OF MICHIGAN

Raymond J. Saulnier
Credit Demand, Money Policy, and the Outlook for the Economy
F. Thomas Juster
Personal Saving and the Deficit
Richard T. Curtin
Consumer Confidence Withstands Interest Rate Gremlins
Richard E. Barfield
Business Economists Predict Good Times to Continue for a While but Expect Recession Next Year
Michael W. Traugott
Tracking the 1984 Presidential Race

ECONOMIC OUTLOOK USA (USPS 330-690)
SUMMER 1984 Vol. 11 No. 3

Published Quarterly by the
SURVEY RESEARCH CENTER
THE UNIVERSITY OF MICHIGAN
426 Thompson Street
P.O. Box 1248
Ann Arbor, Michigan 48106

EDITOR'S NOTE:

ECONOMIC OUTLOOK USA is designed to aid private and public decision makers in achieving a better understanding of the economic and social environment in which they will be operating. The analysis of this publication incorporates direct measurements of the expectations, attitudes and plans of both consumers and business firms with the economic and financial variables traditionally used in forecast models. The philosophy of this publication is that a blend of anticipatory and traditional measures provides richer insights into prospective developments, insights which will produce more consistently reliable forecasts of both economic and social change.

The opinions expressed in this publication represent those of individual authors and do not necessarily reflect the views of the Survey Research Center or The University of Michigan. The editor, as a matter of policy, makes no attempt to reconcile divergent opinions.

SUBSCRIPTIONS:

Regular Subscribers, $27.00 U.S. per year
Academic Subscribers, $13.00 U.S. per year (available to *individual faculty and students* only)

Quantity subscriptions are available at substantial discount. For 1-99 subscriptions, contact the Circulation Manager at the Survey Research Center address (phone: 313–763-5169). Subscribers to 100 or more copies may use their own imprint on the front cover and may use the back cover for a message to customers, executives, and others. Direct inquiries to the Executive Editor at the Survey Research Center (phone: 313–763-5169).

EDITOR: F. Thomas Juster
EXECUTIVE EDITOR: Richard Barfield
CIRCULATION MANAGER: Nellie Beaubien

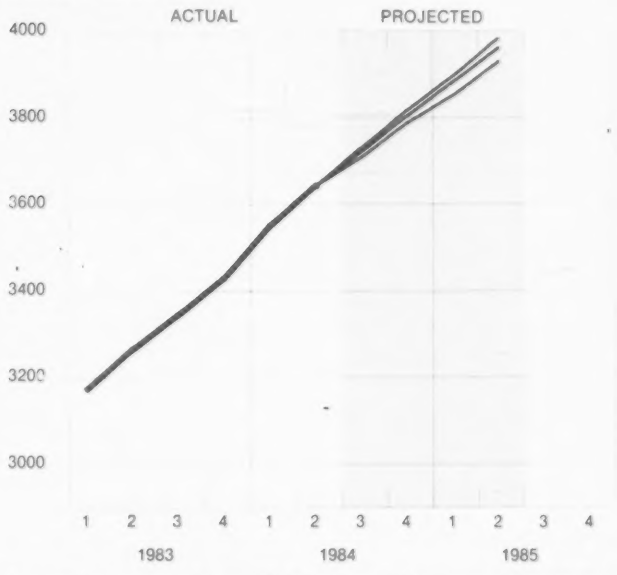
Editorial Board:
Richard Barfield
Richard T. Curtin
F. Thomas Juster
Paul W. McCracken
James N. Morgan
Burkhard Strumpel
Victor Zarnowitz

© 1984 by the University of Michigan. Second-class postage paid at Ann Arbor, Michigan. **Postmaster:** send address changes to ECONOMIC OUTLOOK USA, at the address given above. Printed in the U.S.A.

ECONOMIC PROSPECTS: Actual and projected seasonally adjusted quarterly data at annual rates.

GROSS NATIONAL PRODUCT

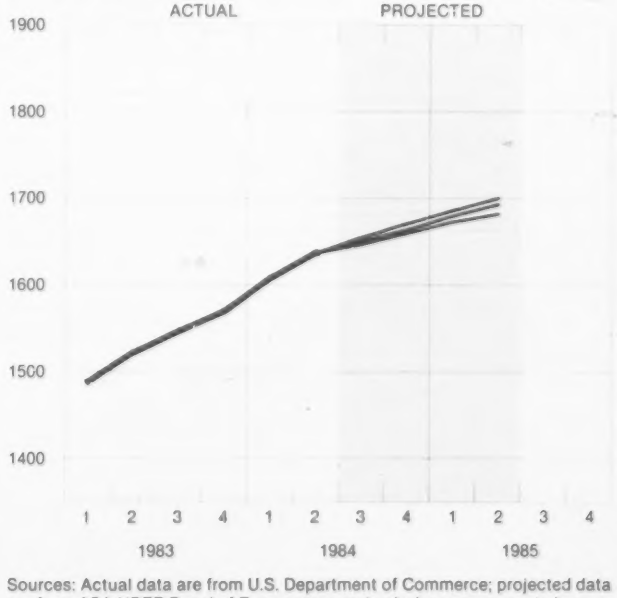
IN CURRENT DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

GROSS NATIONAL PRODUCT

IN CONSTANT 1972 DOLLARS
Billions of Dollars



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Credit Demand, Money Policy, and the Outlook for the Economy

Raymond J. Saulnier
Emeritus Professor of Economics
Barnard College, Columbia University

For reasons having to do with the increase of money supply, it looked in May of this year as if the economy might turn down a good bit sooner than expected by all but a few forecasters, possibly even before 1984 was over. No other outcome seemed possible if the M1 money stock continued to increase for another few months as slowly (just over 2 percent a year) as in March and April. By July, however, that possibility had been eliminated by a resumption of money stock growth at a rate which made up quickly for the earlier lag and, in the circumstances, was more suitable (see Table 1).

TABLE 1. Recent Money Supply Behavior (Percent Change)

Time Period	M1	Total Checkable Deposits	Total Time Deposits
Change Over the Year Ending July 9, 1984	6.3	5.3	8.2
Change Within Three Subperiods of That Year			
7/11/83-3/12/84	6.2	5.0	5.0
3/12/84-5/7/84	2.1	−0.5	9.9
5/7/84-7/9/84	10.8	12.0	20.2

Source: *U.S. Financial Data*, July 19, 1984 (Federal Reserve Bank of St. Louis).

The 1984 Outcome

As things stand, accordingly, the economy can be expected to move up through the rest of this year and into 1985, though not by any means at the fast pace reflected through June in the composite of coincident indicators (see Chart 1). A distinct slowdown is underway, and negative figures will appear with increasing frequency between now and the end of the year, but overall activity will almost certainly continue to move up. Nominal GNP in 1984 should be up nearly 11 percent. With the inflation rate a shade below 4 percent, this implies an increase in real GNP close to 7 percent.

The record is a good one, obviously, but not unusual. Actually, this recovery has moved on a path remarkably close to that plotted by the average of previous post-World War II recoveries.* The surprise was not that it was a good recovery but that it was average when most forecasts (without warrant, it seemed to me) expected it to be less than average.

Prospects for 1985: The Critical Role of Credit Demand and Money Policy

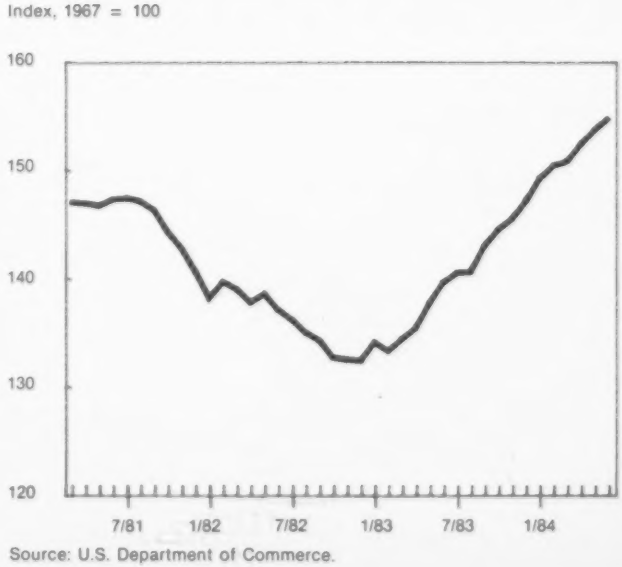
Turning to 1985, prospects depend mainly on what happens in credit markets and in money policy—specifically, on whether credit demand will require an expansion of bank credit and thus of money supply more rapid than can be reconciled with the need (as the Federal Reserve sees it) to prevent, through money policy, a significant speedup of inflation.

Credit demand has already increased substantially, as shown in Table 2. Federal Reserve estimates of the flow of funds in credit markets put total borrowing in the first quarter of 1984 fifty percent higher than in 1982:3, which was the recession trough for credit demand (see Table 3). And that portion of total borrowing that *Business Conditions Digest* calls "private borrowing" increased 60 percent over the same period.

These are large increases, but they are not unprecedented for a recovery period. For example, in the six quarters following 1970:3, also a recession trough for credit demand, private borrowing increased 77 percent; and for a period of comparable length following the credit demand trough in 1975:2, the increase was 133 percent!

What is new today is that we must add to private borrowing a volume of federal borrowing which, if it came from a cyclical budget deficit, would have already dropped sharply but which, because today's budget deficit is mainly structural, remains large. So, we are faced with the question: How will credit demand increase over the next few quarters, given a still large budget deficit? And, can it be met without

CHART 1. Composite Index of Four Coincident Indicators, March 1981-June 1984



Source: U.S. Department of Commerce.

*See the article by Victor Zarnowitz in the Spring 1984 issue.

TABLE 2. Funds Raised in U.S. Credit Markets, Year 1979-First Quarter 1984
(Billions of Dollars)

Time Period	Total Net Borrowing	Borrowing by: U.S. Government	Private Domestic Nonfinancial Sector	Financial Sectors	Foreigners
1979	488.7	37.4	348.6	82.5	20.2
1980	433.7	79.2	264.0	63.3	27.2
1981	489.8	87.4	289.8	85.4	27.2
1982	480.3	161.3	234.1	69.3	15.7
1983:1	518.3	192.9	228.8	81.0	15.6
1983:2	678.2	269.7	318.0	69.3	21.2
1983:3	596.5	167.8	334.2	86.5	8.0
1983:4	730.2	115.8	466.1	122.4	25.9
1984:1	761.1	167.4	479.8	135.7	−21.8

Source: *Flow of Funds Accounts, Seasonally Adjusted and Unadjusted,* First Quarter 1984, p. 51 (Federal Reserve Board).

interest rates' rising to where the economy's advance will be stalled, perhaps even reversed?

How Much Credit Demand in 1985?

Private borrowing moves fairly closely with nominal GNP, and with that quantity rising 10 to 11 percent a year, this portion of credit demand could by the fourth quarter of 1984 be 1¼ times higher than it was at the 1982:3 recession trough. A projection of this amount is indicated in Table 3.

Expanding this estimate of private borrowing to include federal credit demand produces a much larger total, of course, but the addition needed is fortunately not as much as had earlier been expected. One of the best kept secrets recently (but not because the figures haven't been published regularly) is that budget outlays have been increasing at a much reduced rate, thus shrinking the deficit. In the first nine months of the current fiscal year, for example, amounts spent exceeded outlays in the comparable fiscal 1983 months by only 5.3 percent. As a result, the fiscal 1984 deficit could be $5 billion lower than was expected in April. Still, on an annual rate basis it will add between $170 and $175 billion to total private borrowing, and produce an aggregate of credit demand which, by the end of this year and going into 1985, could be roughly twice what it was at the 1982:3 recession trough. Again, the estimate is shown in Table 3.

The Burden on Money Policy

Whether this credit demand can be satisfied within the context of a money policy designed to prevent significant acceleration of inflation depends on the answer to an exceedingly difficult question: How much of this credit demand must be met with funds supplied by the commercial banking system?

Margins of error in projecting funds raised and funds supplied in credit markets are extremely wide, and one can only conjecture at the answer to this critical question. Making the requisite estimates as best one can, and using the commercial banking sector as the residual in the analysis of funds supplied, it looks as if the amount of credit that will be needed from the commercial banking system will involve money supply increases at least at the top of the Federal Reserve's present target range of money supply growth and, if anything, a bit above the top. It follows that if one believes, as I do, that the monetary authorities will be reluctant to see their targets exceeded (they have already said they intend to reduce them in 1985), credit restraint will be the order of the day for some time to come.

This does not rule out the possibility of achieving a "soft landing" in 1985—a growth rate of 3 to 3½ percent with inflation between 4 and 5 percent—but it suggests strongly that it will not be easy to do so. It would be ruled out altogether by a recurrence for a period as long as four months of money stock growth as slow as in March and April of this year. But, considering the relatively favorable outlook for prices, a tightening of money policy to anything like that degree seems to me most unlikely. It is reasonable, accordingly, to rule out recession in 1985.

In this context, and having in mind the slowing already underway in the economy, it is unlikely that interest rates

TABLE 3. Credit Demand in Recovery, with Projections for Fourth Quarter 1984
(Billions of Dollars)

Year:Quarter	Total Net Borrowing in Credit Markets	Total Private Borrowing
1982:3	493.4	247.4
1982:4	510.8	265.7
1983:1	518.3	279.5
1983:2	678.2	391.9
1983:3	596.5	362.2
1983:4	730.2	512.9
1984:1	761.1	396.6
1984:4	985.0	550.0

Sources: (1) Total net borrowing: 1982:3 by telephone from New York Federal Reserve Bank; 1982:4-1984:1 from *Flow of Funds Accounts, Seasonally Adjusted and Unadjusted* (Federal Reserve Board); 1984:4, estimate by author. (2) Total private borrowing: 1982:3-1984:1, *Business Conditions Digest,* June 1984, Series 110, p. 72; 1984:4, estimate by author.

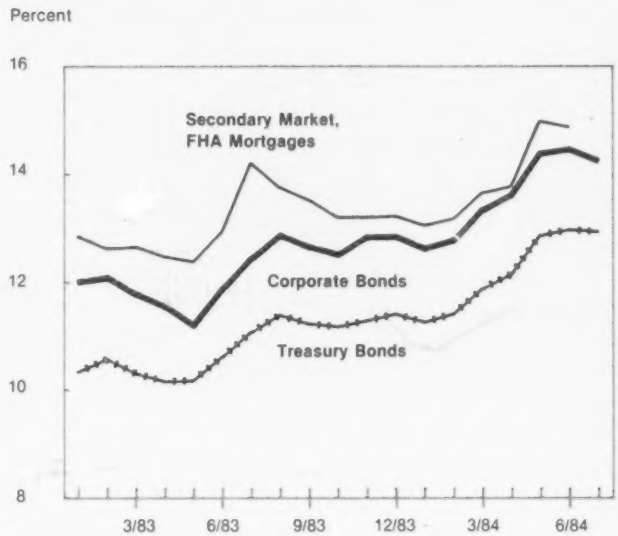
will rise appreciably above the levels reached in June and July of this year (see Chart 2). More likely, they will move down a bit from their June/July levels. Short of recession, however, there is no basis for expecting more than a relatively small decline.

Still a Need for Action on the Federal Budget Deficit

There is no need to dwell on the hazards, present and prospective, that inhere in the condition of the economy, nor any need to emphasize the importance of easing the credit demand problem by legislative action that would reduce the federal deficit. It has been my view all along that to make a significant dent in the deficit would require action on both sides of the budget—on revenues as well as on spending—but President Reagan has said recently, and in my view understandably, that he will oppose tax increases until satisfied that nothing further can be done constructively on spending. This justifies further critical study of expenditure programs, but all parties to the debate will do well to remember that the patient could expire while the doctors are disputing over the treatment.

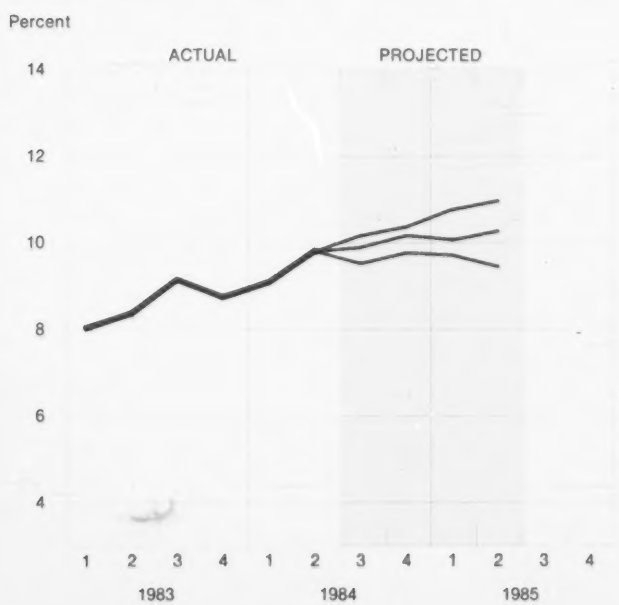
August 1984

CHART 2. Yields on Three Instruments, January 1983-July 1984



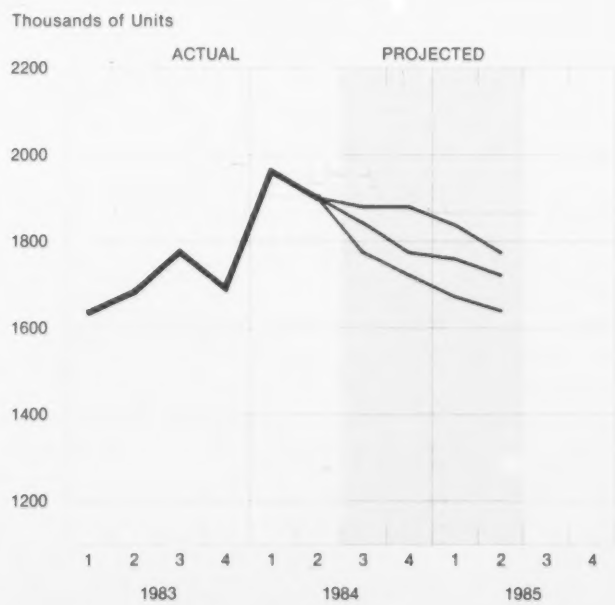
Source: U.S. Department of Commerce.

3-MONTH TREASURY BILL RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

NEW PRIVATE HOUSING UNITS STARTED



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Personal Saving and the Deficit

F. Thomas Juster
Director, Institute for Social Research
Professor of Economics
The University of Michigan

One of the hopes of those who minimize the policy problems associated with massive and continuing federal deficits is that there will be an expansion of the supply of saving forthcoming from the private sector, thereby reducing or even eliminating the prospective credit crunch when rising public and private credit demands collide with inadequate (noninflationary) supplies of available funds. If either business or household saving were to expand greatly, much of the spectre of rising short- and long-term interest rates, with its inevitable impact on business and consumer investment spending, would be blunted.

The tax legislation enacted over the last few years was clearly designed with the idea that it would have a significant impact on private saving, both in the business and household sectors. One can see some modest effect of these tax changes on corporate cash flow, although corporate investment demands are generally projected to rise even more rapidly than corporate cash flow. In the household sector, the three-step income tax cut over the last few years, the liberalized treatment of individual retirement accounts, etc., were thought of as having a potentially major impact on the flow of personal saving from the household sector.

The Two Sources of Savings Data

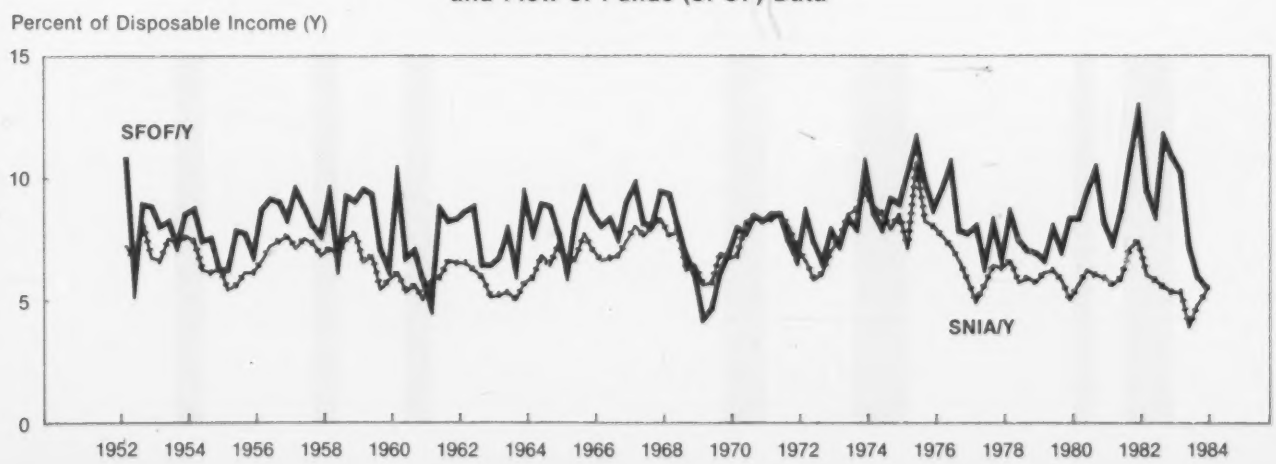
It might be useful to look carefully at recent developments in household saving, to see whether there is any basis for the prognosis that rising household saving will help solve the financial market problem created by actual and prospective deficits. For this purpose, the most useful data on household savings come from the Flow of Funds (FOF) accounts. These differ from the better known and more widely used data on household saving from the National Income and Product Accounts (NIPA).

The differences between the two are both conceptual and statistical. On the conceptual side, FOF treats increases in reserves of public pension fund as a part of both income and saving, while NIPA excludes them from both; in addition, FOF treats net investment in consumer tangible assets (cars and durables) as part of saving, while NIPA treats such expenditures as consumption.* On the measurement side, the two estimates come from totally different sources. FOF data on household saving are estimated as a residual—changes in financial assets and liabilities allocated to nonfinancial corporate business, states and local governments, the financial sector, and the foreign sector are subtracted from total changes of such assets and liabilities to obtain household sector changes. In the NIPA, personal saving is estimated as the difference between personal disposable income and consumer outlays; again personal saving is estimated as a residual.

The conceptual differences in the two series have no effect on analysis of the potential contribution of nonfederal government saving to the solution of the deficit problem, but the statistical differences may provide very different insights into the behavior of personal saving. The two series, adjusted so as to be conceptually comparable with the NIPA definition of saving, are shown in Chart 1. The difference between the two is entirely due to measurement error in one or both series. For the most part, the FOF estimate tends to be higher than the NIPA estimate, and the difference has been especially large during the last three or four years. In fact, FOF estimates personal saving to have been almost twice as large as NIPA saving during a number of recent quarters, although the gap had just about disappeared by the last data point displayed (1983:4).

*The other conceptual differences between the two tend to be minor in quantitative terms.

CHART 1. Saving Rate as Defined by National Income Accounts (SNIA) and Flow of Funds (SFOF) Data



Advantages of and Lessons from the Flow-of-Funds Series

A principal advantage of the FOF series over the NIPA series is that it enables us to examine saving in terms of a set of major components that can be more easily understood in behavioral terms than the total. Chart 2 divides FOF saving into net increases in financial assets (NAFA), net increases in financial liabilities (NIL) and net investment in tangible assets (NTI). The first component represents additions to checking and savings accounts, holdings of bonds and stocks, etc., and is often what people think of when they talk about saving behavior. The second component represents increases in consumer debt of various sorts, primarily installment and mortgage debt, and enters with a negative sign into the calculation of personal saving. The third component is dominantly net investment in owner-occupied housing.

The distribution of FOF data into its principal components is not only relevant for analysis of changes in saving rates over time, but also helps us to decide whether it is more plausible to believe the FOF total or the NIPA total—i.e., to decide where the measurement errors probably are. The test is to ask whether a given FOF saving component seems to be more plausible behaviorally if one assumes that the statistical discrepancy between the FOF and NIPA series reflects a measurement error in that particular FOF component, or whether the series is more plausible behaviorally if one assumes the opposite—that the component is accurately measured, and that the measurement error is either in one of the other FOF components or in the NIPA total. Applying that test to the FOF components summarized in Chart 2 suggests that the measurement error is dominantly lodged in the NAFA component of the FOF series, not in the other components, or by implication, in the NIPA series. The test is not so rigorous that one can have complete confidence in the conclusions, but the results seem plausible and are consistent with what we know a priori about likely measurement errors in the various FOF components and in the NIPA data.

If we adopt the assumption that the statistical discrepancy between FOF and NIPA data basically represents an error in the measurement of household net financial asset acquisitions in the FOF series, then the saving components would be as shown in Chart 3. Those data also assume that the FOF treatment of public pension fund reserves is behaviorally more appropriate than the NIPA treatment, and that the FOF treatment of household tangible asset investment is also behaviorally more appropriate than the NIPA treatment. Thus the series will add up to the NIPA data plus a couple of major components of saving that are normally excluded from the NIPA definition.

What can we learn about saving behavior from the data in Chart 3? First, it seems clear that the major components of household saving have very different trends over the postwar period in the U.S.: saving in the form of additions to financial assets has grown consistently relative to income: (negative) saving in the form of net increases in financial liabilities has also grown consistently relative to income; and saving in the form of net investments in tangible assets has shown a tendency to decline relative to income. Overall, total saving as represented by asset change minus liability change plus net tangible investment shows no trend at all over the postwar period—a finding consistent with studies of the long-term trend of saving in the U.S. going back into the nineteenth century.

A second feature that stands out from Chart 3 is that variations in saving behavior are dominantly a result of variations in consumer debt acquisition, rather than of variations in consumer acquisition of assets. Cyclical variations in consumer spending on housing, cars and durables result in large cyclical variation in consumer acquisition of debt, and these movements dominate the short-term movement of the saving ratio; changes in financial holdings show something of the same cyclical configuration as liability increases, but the movements are smaller and not as important a source of change in saving rates.

Third, there is virtually no evidence to support the hope that an increased flow of personal saving resulting from, e.g., higher after-tax rates of return on assets, will help solve the deficit problem. During the last several years, the overall rate of personal saving has declined slightly. Chart 3 makes it clear that the overall decline is largely a consequence of increases in consumer liabilities running at a faster pace than increases in consumer holdings of financial assets. During economic expansions, that appears to be what usually happens, and the current expansion is no exception.

CHART 2. Net Acquisition of Financial Assets (NAFA), Net Increase in Liabilities (NIL), and Net Tangible Investment (NTI), All Related to Disposable Income

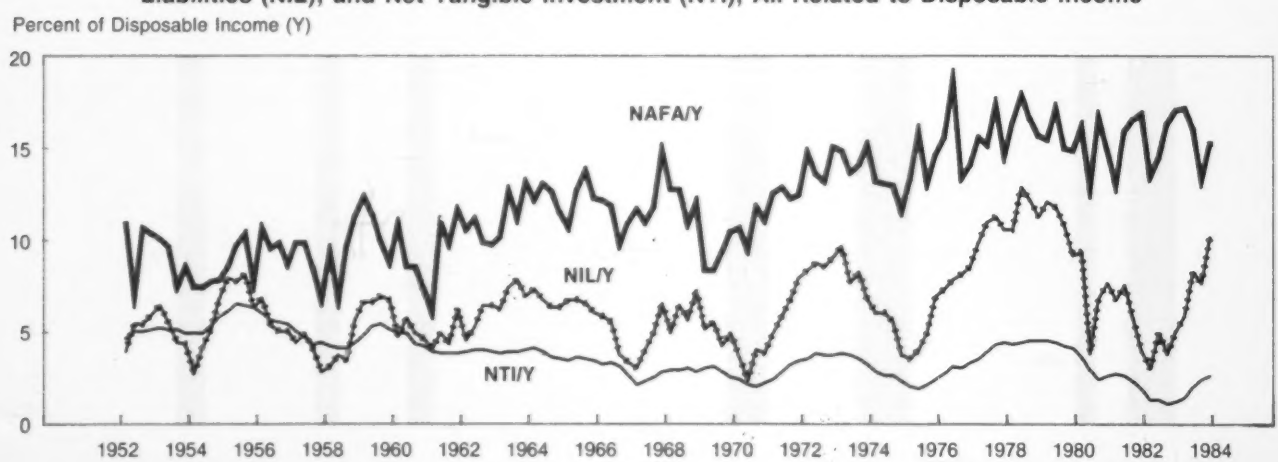


CHART 3. Components of Personal Saving (NAFA', NIL, & NTI')* and Redefined Personal Saving Rate

*NAFA' and NTI' adjusted as discussed in text.

Will Savings Respond to Increased Yields on Assets?

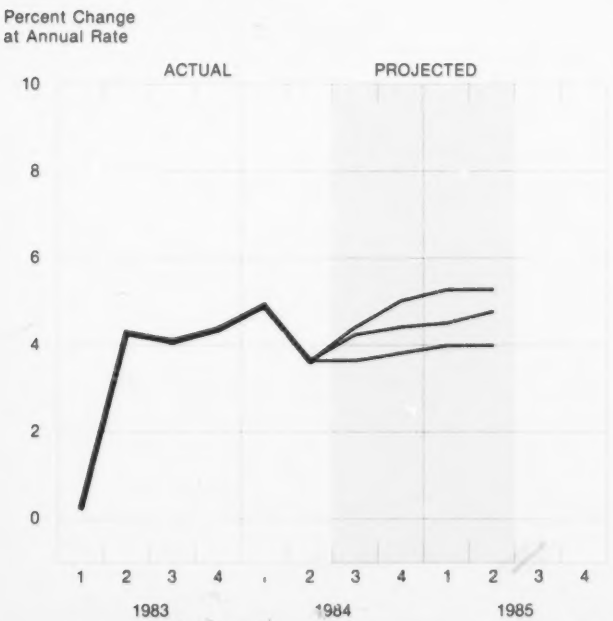
Is there any reason to suppose that the attractiveness of higher rates of return will eventually expand the pool of personal saving? The question is of course complicated, and one cannot get definitive conclusions by observing a couple of time series. But examination of the time-series data offers little support to those who hold the view that consumer saving will respond substantially and positively to rates of return. Not only is there no evidence that consumer assets have risen at a faster pace than usual during the last several years when there has been a substantial enhancement of after-tax returns on assets, but evidence from earlier periods seems to me even more negative. The reader will doubtless recall the behavior of rates of return on assets during the late 1970s, when money-market funds first came into existence. During the period from around 1977 to roughly 1981, holdings of money-market funds by consumers rose from zero to approximately $200 billion. During the same time span, nominal yields on fixed-price assets more than doubled, as did nominal costs of borrowing. Real returns and costs rose much less than that, since inflation rates were rising substantially.

But for many consumers, 1977-81 was a period when effective real after-tax returns on assets actually rose in tandem with nominal after-tax returns, since the invention of money-market funds meant that a great many people could take advantage of rising market yields instead of having to settle for the stable nominal returns offered on conventional savings accounts. Obviously, some consumers have always had access to market yields on assets, but prior to 1977 this option was effectively precluded for a very large proportion of U.S. consumers.

What was the impact of this approximate doubling, for a large fraction of the U.S. population, of real rates of return on assets? Saving in the form of financial asset holdings increased relative to income from about 1977 through 1979, declined sharply in early 1980, rose during the brief recovery from the 1980 recession, then declined again during the 1981 recession. Aside from changes attributable to cyclical forces, what appears to have happened is simply that the enormous expansion in consumer holdings of money-market funds was offset by equally large contractions in consumer holdings of other forms of assets with lower yields. It is hard to see any evidence that the rate of consumer financial saving was affected at all by the substantial change in effective rates of return.

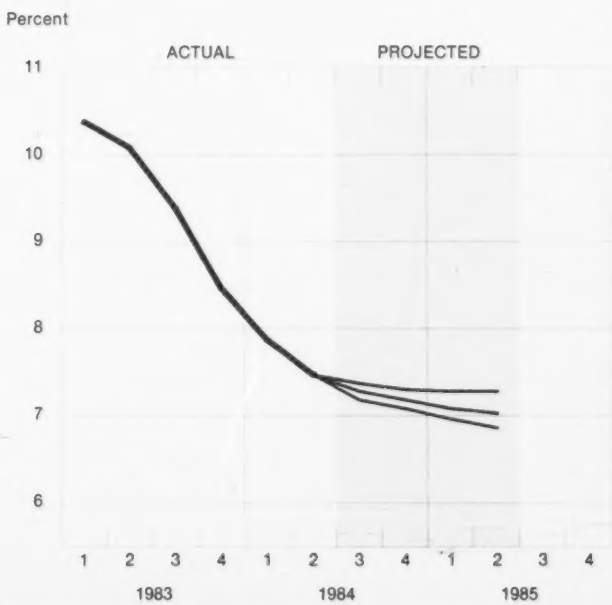
The data thus seem to me consistent with the proposition that increases in rates of return are unlikely to have any noticeable effect on consumer saving in the form of increased holdings of financial assets. But interest rate effects can clearly have a powerful influence on total consumer saving, since they can and have exerted a strong influence on the rate of consumer borrowing. While the evidence on the long-term stability of the ratio of consumer saving to income argues against any long-sustained effect of policy on consumer saving behavior, the data also suggest that the best prospect for impacting the flow of consumer saving is by way of policies designed to impact the liability side of consumer balance sheets, rather than policies designed to impact the asset side. While the administration is clearly supportive of actions to make asset accumulation more attractive (e.g., the tax cuts, actions to expand IRAs), they seem uninterested in actions that might affect liabilities (e.g., the president's statement earlier this year that eliminating or limiting interest deductibility on mortgage loans would not be part of any fiscal action supported by the administration). Unfortunately, the evidence thus suggests that the preferred actions won't do any good, while the ones that might have some effect are unlikely to be adopted.

CONSUMER PRICE INDEX



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

UNEMPLOYMENT RATE



Sources: Actual data are from U.S. Department of Commerce; projected data are from ASA-NBER Panel of Forecasters, revised when necessary to be consistent with latest actual data. The 3 lines display 3rd, 2nd (median), and 1st quartile values from the array of forecasts.

Consumer Confidence Withstands Interest Rate Gremlins

Richard T. Curtin
Director, Surveys of Consumer Attitudes
Survey Research Center
The University of Michigan

Confidence Maintained

In the second quarter 1984 survey, the Index of Consumer Sentiment was 96.6, just below the record 99.5 recorded at the start of 1984 and above the 91.5 recorded one year earlier (see the chart below). Despite the small decline since the first quarter, consumer sentiment during the first half of 1984 has been more favorable than in any prior year during the last decade. Consumers' evaluations of current economic conditions – both for the economy as a whole and for their own families – have remained at very favorable levels. The small overall decline in sentiment has been caused by weakening prospects for further improvement due to concerns with rising interest rates.

Personal Finances: Best in Decade

The proportion of families which reported that their financial situation had improved during the past year was 45 percent in the second quarter 1984 survey, unchanged from the first quarter reading, and the highest level recorded since 1972. Financial reversals were reported by 23 percent of all families in the second quarter survey, just below the 25 percent recorded one quarter earlier, and the lowest proportion recorded in a decade. When asked to explain how their financial situation had improved, 35 percent of all families reported income increases in both the first and second quarter 1984 surveys, the highest frequency since the mid 1970s. Income declines were reported by just 14 percent of all families in the second quarter of 1984, down from a high of 24 percent at the start of 1983.

Editor's Note: Perhaps influenced by the title of Richard Curtin's article in the Spring 1984 issue, the editorial staff entered an incorrectly high value for the 1984:1 data point in the Index of Consumer Sentiment chart. The correct value (99.5) has been entered in this quarter's chart, below.

Although income and employment gains were primarily responsible for the recent improvement, declines in inflation during the past several years have had a substantial cumulative impact. In the first half of 1984, the fewest number of consumers since the early 1970s registered complaints about declines in living standards due to inflation – mentioned by 15 percent of all families in the second quarter of 1984, down from 35 percent three years earlier, and a peak of 46 percent in late 1979.

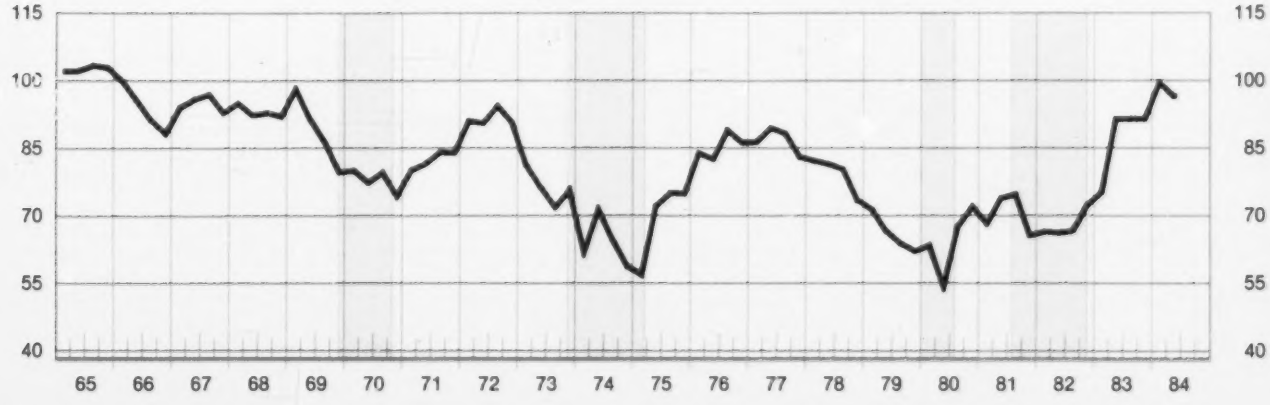
The financial gains reported by families during the first half of 1984 were widely expected in advance, as measured in the prior year's surveys. The number of American families that expected their financial situation to improve reached decade peak levels one year ago, and since then has remained near those favorable levels. In the second quarter 1984 survey, 37 percent of all families expected their financial situation to improve, just below the 40 percent recorded in the second quarter of 1983. Only 12 percent of all families in the 1984:2 survey expected their financial situation to worsen during the year ahead, slightly above the low of 8 percent recorded one year earlier.

Income increases during the upcoming year were expected by 62 percent of all families in the second quarter 1984 survey, just above the 61 percent recorded one year earlier. Across all families, the median income increase expected was approximately 4%. When combined with low rates of inflation, two-thirds of all families thought their incomes would keep pace with or exceed the rate of inflation during the year ahead. This stands in sharp contrast to five years earlier, when the same proportion of families expected nominal income increases (61 percent); but, nonetheless, the majority expected real income declines due to escalating inflation.

The substantial recent improvement in personal finances coupled with very favorable expectations for continued improvement has not only added to income latitude but also

INDEX OF CONSUMER SENTIMENT

February 1966 = 100



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

provided the confidence necessary for the commitment of savings and future income to make large purchases. Record numbers of consumers reported their willingness to draw on accumulated savings to make large purchases in the second quarter survey. Among all families, 42 percent reported that they were willing to use accumulated savings to finance major purchases, just above the 40 percent recorded in the first quarter, and the highest level recorded in ten years. Willingness to incur new debt was not as widespread, being reported by 29 percent in the first and second quarter 1984 surveys; but this was also the highest level recorded in nearly ten years.

Slower Economic Growth Expected

Improvements in business conditions in the country as a whole were reported by 68 percent of all families in the second quarter 1984 survey, just below the 71 percent recorded in the first quarter of 1984. Even after this small decline, assessments of current business conditions during the first half of 1984 were more favorable than at any other time during the past 30 years.

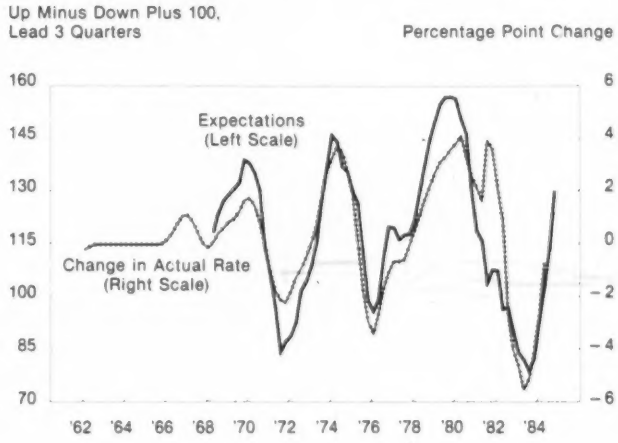
Although evaluations of current business conditions are now at record favorable levels, expectations for future improvement in the economy reached cyclical peak levels one year ago, and have since then declined significantly. In the second quarter 1984 survey, 31 percent of all families expected business conditions to improve during the year ahead, down from the peak of 52 percent one year earlier. The expectation that the economy would worsen during the year ahead was not very common, rising to 14 percent in the second quarter survey from 7 percent one year earlier. Rather then renewed declines, the majority of consumers expected the economy to remain at its current improved level during the year ahead (53 percent). Despite the expected slowdown in the pace of economic growth, 61 percent of all families in mid-1984—the same proportion as in mid-1983—reported that they expected the continuation of good times financially in the economy as a whole during the upcoming year.

Rising Interest Rates Dominate Concerns

When asked about the most recent changes in business conditions—those which occurred during the past several months—the mix of economic news heard and recalled by consumers became less favorable by mid-1984, but on balance still remained positive. During the past year, the dominant shift in consumers' awareness of ongoing developments involved fewer favorable references to credit conditions (3 percent, down from 16 percent), as well as more frequent references to rising interest rates and tight credit conditions (10 percent, up from 1 percent).

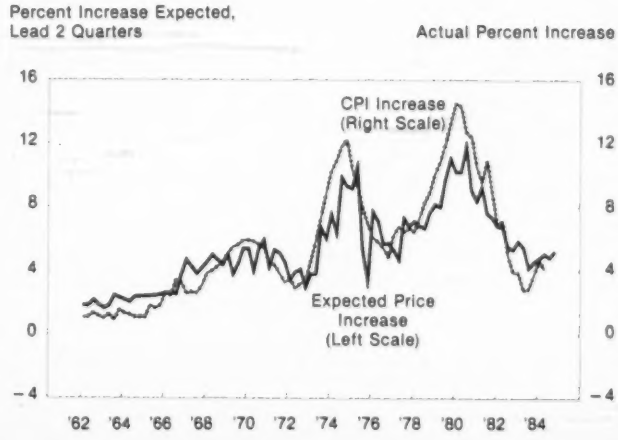
Expected trends in inflation, unemployment, and interest rates reached their most favorable cyclical levels one year ago. Since then only small reversals in inflation and unemployment expectations have been recorded. Interest rate expectations, in contrast, have become very unfavorable, and represent the major factor behind the expected decline in the pace of economic growth. Among all families in the second quarter 1984 survey, 66 percent expected interest rates to increase during the year ahead, up from 40 percent in the first quarter of 1984, and 23 percent one year earlier. Declines in interest rates during the year ahead were expected by just 9 percent of all families in the second quarter, down from 31 percent one year earlier. Interest rate expectations held by consumers have shown a close correspondence with actual subsequent changes. Using four-quarter moving averages, the time series correspondence between interest rate expectations lead two quarters and the annual percentage point change in the price rate is shown in Chart 1. The time series correlation was $r = 0.85$.

CHART 1. Interest Rate Expectations and the Percentage Point Change in the Prime Rate



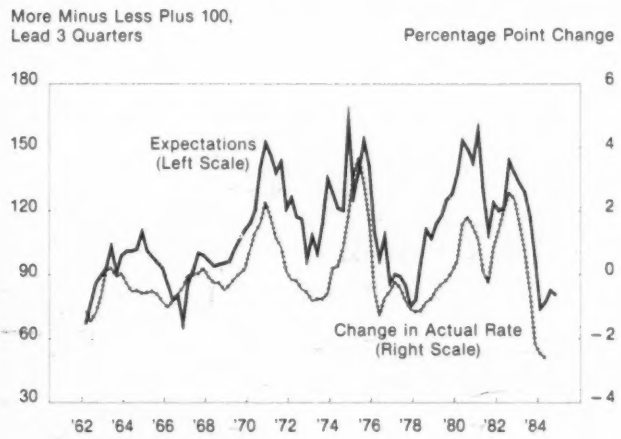
Consumers expected prices to increase at an annual rate of 5.3% in the second quarter 1984 survey, up form 4.9% one quarter earlier, and 4.6% one year earlier. Nearly half of all families (48 percent) expected price increases in the range of 1-5% during the year ahead—which represents an unusually high degree of consensus. The time series correspondence of price expectations held by consumers and subsequent changes in the CPI is shown in Chart 2. With a lead time of two quarters, the time series correlation was $r = 0.92$.

CHART 2. Mean Expected Price Increase over the Next 12 Months and Actual Increase in the CPI (All Urban Consumers, All Items, SAAR)



The majority of consumers in the 1984 second quarter survey expected the rate of unemployment to remain largely unchaged at its current reduced level during the year ahead (52 percent). The proportion of families that expected further declines in the unemployment rate fell to 27 percent in the 1984:2 survey, down from 40 percent one year earlier. Increases in unemployment during the year ahead were expected by 20 percent of all families, up from 15 percent one year earlier. The time series correlation between unemployment expectations lead three quarters and the annual percentage point change in the aggregate unemployment rate was r = 0.76 (see Chart 3).

CHART 3. Unemployment Expectations and the Percentage Point Change in the Unemployment Rate



Buying Conditions Remain Favorable

More families held favorable opinions of buying conditions for large household durables in the second quarter 1984 survey than at other any time during the past thirty years. Among all families, 72 percent favorably rated buying conditions for household durables, just above the 71 percent recorded in the first quarter. Much of the improvement in buying attitudes towards durables was recorded one year ago—from mid-1982 to mid-1983—when the proportion holding favorable attitudes rose from 43 to 64 percent. The primary reason for the rapid initial rise as well as the more modest gains during the past year has been favorable perceptions of market prices. In the second quarter of 1984, 31 percent of all families referred to the availability of discounted prices for household durables, compared with only 11 percent that complained about high prices.

Favorable attitudes toward buying conditions for vehicles were held by 61 percent of all families in the second quarter 1984 survey, just below the 64 percent recorded one quarter earlier, and the cyclical peak of 65 percent recorded one year earlier. References to the availability of price discounts on vehicles were made by 19 percent of all families in the second quarter of 1984, down from 26 percent one year earlier, and the cyclical peak of 35 percent recorded two years earlier. At the same time, complaints about high car prices were made by 20 percent of all families in the second quarter of 1984, just above the cyclical low of 17 percent recorded at the start of 1984. The appeal of buying-in-advance of rising vehicle prices increased somewhat during the past year, having been mentioned by 17 percent of all families in the second quarter survey, up from 10 percent one year earlier, and the cyclical low of 7 percent two years earlier. References to the availability of lower interest rates on vehicle loans declined sharply during the past year, falling to 14 percent in the second quarter of 1982 from 38 percent one year earlier.

Favorable attitudes toward buying conditions for houses were held by 59 percent of all families in the second quarter 1984 survey, just below the 61 percent recorded one quarter earlier, and the cyclical peak of 64 percent recorded one year earlier. When asked to explain their views on buying conditions for houses, the proportion of families that mentioned the availability of lower prices fell to 13 percent in the second quarter of 1984 from the 20-year high of 23 percent recorded one year earlier. Despite this decline in favorable perceptions, the proportion of families that registered complaints about high home prices fell to 12 percent in the second quarter 1984 survey from 13 percent one year earlier, and was the lowest proportion recorded in 20 years. In addition, references to buying-in-advance of rising home prices have not significantly increased during the past year, rising to just 9 percent in the second quarter of 1984 from 7 percent one year earlier. Consequently, although fewer consumers reported the availability of price discounts, current housing prices are not viewed as too high and therefore cause for postponement, nor do consumers expect future price increases to warrant advance buying.

In reaction to the expected increases in interest rates, however, more families have been citing the advantage of buying-in-advance of rising interest rates. Among all families in the second quarter 1984 survey, 20 percent cited the advantage of borrowing in advance of mortgage rate increases, up from 9 percent one year earlier, and the highest level ever recorded in these surveys. At the same time, references to the current availability of lower mortgage rates fell to 25 percent in 1984:2, about half the 48 percent recorded one year earlier. As a result, consumers' initial reactions to recent mortgage rate increases have acted to forestall declines in favorable home buying attitudes, and have accelerated purchase timing. But these shifts in views of buying conditions have also made home buying attitudes more vulnerable to sharp reversals.

Summary Outlook

The small second quarter decline from record levels does not detract from the otherwise very favorable level of consumer sentiment. Recent shifts in consumer attitudes and expectations have reflected a typical cyclical pattern: expectations reached peak levels first, followed by peak levels in evaluations of current economic conditions. One year ago, a wide range of expectations measures reached their most favorable cyclical levels, including inflation, unemployment, and interest rate expectations. Since then, unemployment and inflation expectations have remained at very favorable levels. Only interest rate expectations have become very unfavorable, and they represent the primary factor underlying the expected slowdown in economic growth.

Nonetheless, the renewed strength in personal finances, coupled with favorable attitudes toward buying conditions, points toward continued high sales levels through 1984 and into early 1985. Moreover, the widespread expectation of increases in interest rates since the start of 1984 has prompted some consumers to favor buying-in-advance of rising interest rates. To be sure, consumer buying decisions have been and will continue to be very responsive to interest rate trends. Sales of houses, cars, and large household durables are likely to weaken along with interest rate increases, while non-interest-sensitive purchases continue to post gains. Unlike the period of growth in consumer sales in the mid 1970s, when low real interest rates tilted spending in favor of credit purchases, the current high real rates will favor non-credit purchases.

August 1984

Business Economists Predict Good Times to Continue for a While But Expect Recession Next Year

Richard E. Barfield
Survey Research Center
The University of Michigan

The ninth in the series of quarterly surveys of National Association of Business Economists (NABE) members was conducted in early May. Respondents were asked to forecast various economic series and to give their opinions about current economic policy matters. For analytical purposes, the business economists were classified according to their primary affiliation in six groups: manufacturing, nonbank finance, trade associations and others not elsewhere classifiable, government and academic, commercial banking, and consulting.

Conditions in Company/Industry

Throughout the survey program, economists affiliated with a business firm (that is, those in manufacturing, commercial banking, or nonbank finance) have been asked about quarterly trends in various economic aspects of their own company or industry. Results from the May survey are displayed in Table 1 and generally reflect the continuing economic expansion experienced during the three months preceding the survey:

- Demand had been increasing in three-quarters of the companies, and employment had been rising or stable in more than 90 percent. But only about 40 percent of economists in nonbank finance reported demand increases, and only about 20 percent of those in commercial banking mentioned rising employment.
- Inventories had been increasing in about half the firms and decreasing in 13 percent.
- Real capital outlays had been rising in over 40 percent of the companies and falling in less than 10 percent, with no substantial differences among the affiliation groups.
- Profit margins had been going up in somewhat over 40 percent of the firms and stable in somewhat over a third, though fully 70 percent of manufacturing firms reported rising profits.
- Prices had increased in half the firms and declined in only 5 percent, but these aggregate figures mask considerable differences among the three groups. Fully 85 percent of the NABE members affiliated with commercial banks reported that prices had risen during the three previous months, while only 6 percent of those in nonbank finance so reported.
- Wages and salaries had been rising in about two-fifths of the firms and stable in nearly three-fifths, with virtually none reporting falling compensation. There were no substantial differences among the affiliation groups here.

TABLE 1. Trend in Various Economic Aspects of Respondent's Company or Industry During Three Months Prior to May 1984 Interview (Percentage Distribution)

Economic Aspect	Rising	Same	Falling
Unit Volume of Demand	75	20	5
Employment	36	55	9
Unit Volume of Inventories	51	36	13
Real Capital Outlays	43	51	6
Profit Margins	43	37	20
Prices Charged	50	45	5
Wage Rates & Salaries	41	57	2

These aggregate trends were broadly similar to those reported in the previous (February 1984) survey, with two exceptions: both inventory volume and prices charged were more likely to have been rising in the three months prior to May than in the three months prior to February.

Economic Forecasts

Table 2 displays the median values of forecasts made in May for selected economic series; analogous results from the previous survey are also displayed. Real GNP was expected to increase by nearly 5 percent from 1983:4 to 1984:4 and by close to 6 percent for the full year 1984 compared with 1983; both values were substantially higher than the ones given in the February survey. The business economists expected GNP growth to taper off in 1985, to about 3½

TABLE 2. Forecasts of Selected Economic Series, February 1984-May 1984

Series	Median Value	
	Feb. 84	May 84
Annualized Percent Change:		
Real GNP		
1983:4-1984:4	4.20	4.92
Year 1983-Year 1984	4.80	5.73
Year 1984-Year 1985	–	3.41
Consumer Price Index		
1983:4-1984:4	5.02	5.19
Year 1983-Year 1984	4.84	4.97
Year 1984-Year 1985	–	5.99
Real Fixed Investment		
1983:4-1984:4	9.61	10.13
Year 1983-Year 1984	11.02	12.85
Year 1984-Year 1985	–	7.93
Percent:		
Unemployment Rate		
1984:3	7.97	7.80
1984:4	7.90	7.43
Year 1984	8.01	7.93
Prime Rate		
6/30/84	11.10	12.71
9/30/84	–	12.88
12/31/84	11.63	13.04
Millions of Units:		
New Private Housing Starts		
1984:4	1.70	1.70
Year 1984	1.70	1.80
Year 1985	–	1.60
Automobile Sales		
1984:4	10.26	10.11
Year 1984	10.01	10.14

Note: Dash indicates forecast not asked for in February

percent compared with 1984. Consumer prices were forecast to increase by somewhat over 5 percent fourth quarter to fourth quarter and just about 5 percent year over year, both estimates being slightly higher than the ones given in February. Price change was expected to accelerate to the 6 percent range in 1985 as compared with 1984. Real fixed investment was foreseen to increase by a bit more than 10 percent from 1983:4 to 1984:4 and by nearly 13 percent year over year – both estimates half a percent to a percent higher than the ones given in February. But the increase in real investment was expected to moderate to the 8 percent range from 1984 to 1985.

The business economists predicted that the unemployment rate would decline from 7.8 to about 7.4 percent from the third to the fourth quarters of this year and to average slightly less than 8 percent for the year as a whole; these estimates were all somewhat lower than the February ones. The prime rate was expected to climb from about 12¾ percent to 13 percent during the second half of 1984, substantially higher than the figures given in February but – in the light of subsequent developments – probably still too low.

New private housing starts were expected to average 1.7 million units during the fourth quarter and 1.8 million units during the year as a whole, the latter estimate a bit higher than the one given in February. But housing starts were expected to decline to the 1.6 million level for the year 1985. Automobile sales were forecast to average about 10.1 million units in 1984:4 and for the year as a whole, respectively slightly lower and higher than the February estimates.

There were few notable differences in the forecasts among the several affiliation groups. For the CPI forecasts, economists in financial institutions were slightly higher than the others; for the prime rate forecasts, consultants were slightly higher; for housing starts and car sales, government/academic economists were somewhat lower. And economists in manufacturing were more optimistic about auto sales than the other NABE members.

The two regional forecast questions asked in some previous surveys were repeated in the May survey, with the business economists being asked whether the overall economic growth rate and the unemployment rate in their part of the country would be higher than, lower than, or about the same as the national rate during 1984. Concerning real GNP growth, more than half the respondents in the South and about two-thirds in the West expected faster-than-average change, followed by about a third in both the North Central and the Northeast regions. But 41 percent of the North Central economists expected slower-than-average growth, compared with 22 percent of those in the Northeast. Concerning unemployment, the expectations were more polarized: about three-quarters of Southern business economists expected lower-than-average local unemployment rates, followed by about one-half of those in the West and Northeast; but only 11 percent of economists in the North Central region projected their unemployment rate to average lower than the national rate, while 81 percent saw it as likely to be higher.

Fiscal and Monetary Policy

As in all previous surveys, the business economists were asked about recent fiscal and monetary policy. Trends over the past four surveys in their assessment of the appropriateness of fiscal and monetary policy are displayed in Table 3. The distribution of opinion about fiscal policy was virtually unchanged between February and May, with the overwhelming majority holding that then-current fiscal policy was too stimulative. The proportion of business economists

TABLE 3. Trends in Opinions about Fiscal and Monetary Policy, August 1983-May 1984 (Percentage Distribution)

Opinion	August	November	February	May
Fiscal Policy:				
Too Stimulative	76	73	82	83
About Right	20	22	14	14
Too Restrictive	4	5	4	3
Monetary Policy:				
Too Stimulative	23	3	3	12
About Right	69	82	78	74
Too Restrictive	8	15	19	14

The questions were "What is your view about current fiscal policy – is it too stimulative, too restrictive, or about right?" and "What is your view about recent monetary policy actions – have they been too stimulative, too restrictive, or about right?"

subscribing to that view ranged from about three-quarters in manufacturing and trade associations to about 95 percent in commercial banking and nonbank finance.

Three other questions relating to fiscal policy were posed in the May survey. Respondents were asked to give an estimate of federal budget deficits for fiscal years 1984 and 1985. The aggregate prediction for FY 1984 was $179 billion, ranging from a low of $170.3 billion from the commercial banking group to a high of $186 billion from the consulting group. For FY 1985 the overall forecast was $181.5 billion, with a low of $177.5 billion given by the consultants and a high of $189.8 billion given by the economists in trade associations. Respondents were asked to predict the effect of a Congressional deficit-reduction package of $50 billion in tax increases and $100 billion in spending cuts on financial markets. Nearly three-quarters expected that enactment of the package would reduce long-term interest rates at least slightly, with most of the rest anticipating essentially no effect. Economists in nonbank financial institutions were least likely to expect downward pressure on long-term rates from the package; those in consulting were most likely to expect a decline. Regardless of their opinion as to the effect of any tax-increase-and-spending-cut package passed by Congress this year, the economists were asked whether they expected a larger such package to be enacted next year, after the presidential election. Fifty-seven percent of all respondents expected an enactment in 1985, though only 28 percent of government and academic economists agreed.

Concerning recent monetary policy, the May survey indicated some change in opinion from the February survey, basically involving a small shift toward viewing it as too stimulative. Even so, the substantial majority continued to see monetary policy as about right, just as they have for the balance of the survey period. Among the affiliation groups, only the consultants were substantially divergent from the overall consensus, with 25 percent seeing monetary policy as too stimulative, 54 percent as about right, and 21 percent as too restrictive. Somewhat related to monetary policy was the question asking about the change expected in the international value of the dollar (calculated on a trade-weighted basis) between the survey date and the end of the year. About two-thirds of the economists expected at least some decrease, with a substantial fraction (39 percent) only of government/academic economists expecting a continued increase in the dollar's value.

Duration of the Current Expansion

As in the prior two surveys, the business economists were asked about the duration of the current expansion. Specifically, they were asked "in what year and quarter do you expect the current expansion to peak?" Results are displayed in Table 4. Overall, the modal quarter was 1985:3; and more than two-thirds expected the peak to occur by the end of 1985. Government and academic economists were somewhat more likely to expect a quick end to the expansion (over a quarter forecast it to occur this year), and those in commercial banking were somewhat more likely to see it continuing into 1986 or 1987. But the consensus was certainly that the expansion is likely to be shorter than the postwar average of 46 months.

Those economists who were part of this consensus (that is, those who expected a peak before 1986:3) were asked to give up to three reasons for expecting the current expansion to be shorter than the postwar average. The first reason given was overwhelmingly "high interest rates," with more than 75 percent of respondents in each affiliation group agreeing. Second responses were almost as concentrated, with over two-thirds specifying "large federal budget deficits," and no less than 60 percent in each affiliation group agreeing. (Of course, Martin Feldstein, among others, might argue that these first and second responses are merely the two sides of the same coin.) As would probably be expected, the third reason given for a shorter-than-average expansion was more scattered among the several possibilities, though even here almost half of all those giving a third reason specified "a continuing loss of competitiveness by U.S. industries in world markets." Other third reasons mentioned were "international default by one or more major debtor countries" and "a major labor strike."

TABLE 4. Expected Year for Peak of Current Business Cycle by Primary Affiliation of Business Economists, May 1984 (Percentage Distribution)

	Primary Affiliation Group						
Year:Quarter	Manufacturing	Nonbank Finance	Trade Associations & "Other"	Government & Academic	Commercial Banking	Consulting	All Groups
1984:3 or Earlier	12.5	5.6	4.1	16.7	5.1	8.7	8.2
1984:4	2.1	5.6	4.1	11.1	2.6	4.3	4.1
1985:1	4.2	22.2	2.0	5.6	7.7	21.7	8.2
1985:2	18.8	11.1	14.3	11.1	7.7	8.7	12.8
1985:3	22.9	16.7	16.3	16.7	23.1	17.4	19.5
1985:4	18.8	11.1	24.5	11.1	12.8	8.7	16.4
1986:1	2.1	16.7	10.2	11.1	10.3	0.0	7.7
1986:2	6.3	5.6	4.1	5.6	15.4	13.0	8.2
1986:3	2.1	0.0	10.2	0.0	10.3	4.3	5.6
1986:4	6.3	0.0	6.1	11.1	0.0	4.3	4.6
1987:1 or Later	4.2	5.6	4.1	0.0	5.1	8.7	4.6

The question was "In what year and quarter do you expect the current business cycle expansion to peak?"

Tracking the 1984 Presidential Race

Michael W. Traugott
Center for Political Studies
The University of Michigan

The 1984 presidential campaign is breaking new ground along a number of fronts as the Democratic team of Walter Mondale and Geraldine Ferraro seeks to unseat Republican incumbents Ronald Reagan and George Bush.

Most significantly, a woman has been selected for the first time to run on a major-party ticket. And active campaigning is starting earlier, portending a very bitter finale as the wear and tear of the extended struggle catches up with the candidates near November 6.

Given the increased volatility in the American electorate which has been observed across the last several elections, it is unwise to prognosticate about events which will occur three months from this writing. But it is possible to discuss the basic elements of strategy which the Democrats and Republicans are likely to pursue and to provide a perspective on the flow of the campaign as it seems likely to unfold.

The Basic Strategy of Presidential Campaigns

The most important element underlying an understanding of political campaigns is the significance of party identification as an anchor for voters' interpretations of political events and actors. It also serves as a screening device for political information. The reality of the distribution of partisans determines strategy for each side.

By party identification, political scientists mean the tendency or willingness of individuals to indicate their preference or psychological attachment to a political party. This concept is developed early, beginning with socialization in the family, and is usually quite enduring. In any constituency, there is an underlying distribution of party identification which can be measured with surveys and which represents the collected sentiments of the voters who reside there.

There are two important adjustments which are typically made to this distribution of partisanship among adults in order to translate it into an indicator of a likely electoral outcome. The first is compensation for the fact that Democrats as a whole are less likely to vote than people who call themselves Republicans. And the second is a correction because Democrats are also more likely to defect and vote for candidates of the other party than Republicans are.

When these two factors are taken into account, a large Democratic advantage in identification nationwide gets translated into a slight Democratic advantage in the "normal" or expected vote. Treating the entire United States as the constituency for a presidential election, then, a substantial Democratic plurality in identification results in an advantage of about 54 percent to 46 percent in the normal vote.

This fundamental numerical advantage suggests that, first, we would expect the Democratic candidate to win—all other things being equal. And secondly, Democrats and Republicans run characteristically different campaigns in trying to forge an electoral majority. It is true that all other things are not equal when a Republican incumbent is running for reelection under as favorable domestic economic circumstances as Ronald Reagan, and more will be said about that below.

The inherent advantage of the majority party is that it can run a campaign of *mobilization* whereby it focuses its attention on its natural constituency, tailoring appeals designed to stimulate turnout on election day. For the minority party, on the other hand, there has to be a campaign involving *conversion*. In addition to maintaining its core support, it must provide partisans in the other camp with a good reason for defecting, usually based upon a substantive issue or a personal quality of its candidates such as leadership ability or integrity.

In other words, the Democrats can win in principle if they can get their own troops to the polls. In national campaigns, the Republicans have to appeal to independents and Democrats more directly because a winning coalition has to include voters other than their own partisans in order to reach majority proportions. This fact explains the tendency of Democratic campaigns to emphasize "traditional Democratic values" including the highlighting of past leadership going back to Franklin D. Roosevelt. It also explains the Republicans' reliance on the personal characteristics of their candidates, a selective issue emphasis, and a general downplaying of party in their appeals.

The 1980 election involved a classic campaign in these terms. The anemic condition of the U.S. economy provided the background for Ronald Reagan's appeal for voters' consideration of how well off they were four years before in comparison to their economic condition in November 1980. His central thrust against the Carter campaign was an attack on leadership ability cast in terms of competence. Survey data collected before and after the election show that these arguments were quite telling, and they made a difference in the last two weeks of the campaign in conjunction with the debate in Cleveland and the breakdown in hostage negotiations in the weekend before the election. In the end, Jimmy Carter suffered from an unusually high defection rate among Democrats, more than twice as great as it had been in his successful 1976 campaign against Gerald Ford.

In the 1984 campaign, we can expect the Reagan team to return to the economic theme, and it should be quite common to hear the 1980 question on personal economic circumstances repeated. Inflation is down, unemployment has declined to the level at which it stood when Reagan took office, and a broad recovery is clearly underway. Reagan and Bush will ask for the second term they need to complete the work which they have only just begun.

Ronald Reagan has been one the of the most popular incumbents to serve in the White House since World War II. The significance of that date is its correspondence to the general advent of the application of the survey method to popular political issues. One of the longest time series of data we have is the Gallup Poll question on presidential approval dating back to Harry Truman.

Most incumbent presidents have experienced a fairly consistent decline in popular support during their term of of-

fice, observed by superimposing each one's approval rating on the others' ratings according to their length of service. For any president, there are short-term upswings due to favorable economic changes or positive international events; at the same time, there have been unusual and precipitous drops that can be linked particularly to unfavorable international events. But generally there has been a "honeymoon period" of popular support which has lasted for a few months upon taking office and then a more or less gradual decline in support which sets in for the rest of the term.

With the exception of negative reaction to the sending of troops to Lebanon, there has been no significant decline in Ronald Reagan's popular support since his inauguration. A slight majority of those surveyed in the latest national polls approve of the way he is handling his job as president, just as was the case almost four years ago. He has been significantly effective in receiving credit for work well done and disassociating himself from many of the problems which have plagued his administration.

As a result of this, it is not likely that the Democrats will make much headway by attacking the president personally. Rather, they can be expected to make appeals to their traditional constituency by raising the question of at whose expense the recovery has been achieved. One element of this is the so-called "fairness" issue—who has borne the brunt of unemployment, has benefited differentially from the tax cut, and will suffer most from the additional budget cuts and/or tax increases needed to reduce the deficit?

Another emphasis in the Democratic campaign is likely to be on the future of the country, because they have little to gain by challenging directly the Reagan achievements of the past four years, especially as they relate to domestic economic conditions and individuals' personal economic circumstances. Measures of consumer sentiment now show high levels of satisfaction with current economic conditions but increasing concern about economic prospects down the road, particularly for the national economy.

The Contribution of Geraldine Ferraro to the Democratic Ticket

Presidential candidates have long selected their running mates with an eye toward regional or ideological balance of the ticket. This represents a form of strategic decision-making designed to appeal to significant groups in the electorate who are either part of their regular constituency or who have to be attracted to form a coalition of winning size. The selection of a woman for the Democratic ticket represents a bold but nevertheless similar strategic decision by the Mondale forces. And it is peculiarly suited to the campaign which they face in 1984 as the majority party candidates trying to defeat a Republican incumbent.

The decision is a long overdue but simple strategic calculation because it acknowledges the role of women in the contemporary American electorate. Not only do they represent a majority of the voting age population, but they are now voting at a rate which exceeds that for men. As a result, they represent a majority of the electorate in greater proportion than of the voting age population.

It is also the case that women have consistently been more critical of Ronald Reagan and his policies since 1980 than men have. While this has usually been discussed in terms of the "gender gap," it is also important because women have demonstrated an increasing tendency to identify themselves with the Democratic party as a result of this dissatisfaction. Women do not represent a monolithic voting group tied to one party, of course, but the net increase in Democratic partisans across the last four years has come primarily from women in the electorate.

Ronald Reagan's 1980 victory was achieved with sizable Democratic defections, especially among men. Considering the basic elements of a mobilization strategy, therefore, and the need to bring their own partisans back into the fold, the Democrats' selection of a woman could be expected to boost their chances on a number of grounds. Women now represent the single largest constituency within the Democratic party—more numerous than any regional group or such traditional supporters as union members or blacks. The selection of a woman has the real potential to solidify basic support among Democrats and stem the tide of defections, and this is a strategy which is obviously best suited to the majority rather than the minority party.

Secondly, the selection of a female vice-presidential candidate should stimulate registration and turnout among women which, in the aggregate, should also benefit the Democratic party. A fundamental element of the Democratic strategy in the fall will be to register more members of their natural constituencies and get them to the polls, and this will include large numbers of women. Finally, the mobilization of women should result in an increase in campaign contributions and a new cohort of campaign volunteers as many get involved in politics for the first time or see a reason to increase their activity. This should help the Democrats as well.

There are suggestions in preliminary surveys taken around the Democratic convention that this strategy has some merit. Asking about the effects of selecting a woman for the ticket is not the same as asking specifically about the selection of Geraldine Ferraro. The former question evokes general elements of stereotypes while the latter has a more real anchor in a specific individual. Data on the choice of a woman from a survey conducted in Michigan in June are available and quite similar to those collected in other state and national surveys, and they indicate that the potential is clearly there for a strong Democratic benefit from the selection of Ferraro. They also indicate the danger of analyzing political information without taking party identification into account.

Data are presented in Table 1 which give the answers of all respondents and men and women by their party affiliation to a pre-convention question about their support of the Democratic ticket in the fall if Walter Mondale were to choose a woman for vice-president. For the vast majority (about three out of four respondents) it would make no difference. And about as many of the remainder said it would make them more likely as less likely to support the Democrats. These are the data which have been commonly reported as showing that Ferraro's selection would be a "wash" for the ticket.

But there are substantial differences by party masked in these data for all respondents. Republican men and women would be much less likely (by a two-to-one margin) to support the ticket, although their initial inclinations to do so were obviously very weak to begin with. Independent men seemed to be reserving judgement about who the candidate would be, although independent women were somewhat more likely to indicate support than not. Democratic men were also evenly divided in their potential strength of support for Mondale with a woman on the ticket. But one-fifth

TABLE 1. Effects of Choosing a Woman for Vice-President on Support of the Democratic Ticket* (Percentage Distribution)

Group	More Likely	Less Likely	Depends Who It Is	Makes No Difference
All Respondents	12	10	5	73
Men Who Are...				
Republicans	7	14	6	73
Independents	3	2	20	75
Democrats	10	10	4	76
Women Who Are...				
Republicans	9	17	1	73
Independents	14	11	5	70
Democrats	19	6	4	71

*"If Walter Mondale chooses a woman for Vice-president, would it make a difference in whether or not you vote for the Democrats in November? (IF YES) Would you be more likely or less likely to vote for the Democrats?"

of the Democratic women (19%) indicated they would be more likely to support such a ticket, about three times as many as said they would be less likely to. One way to increase the vote of Democratic women for the ticket would be to add a woman to the slate.

So the potential contribution of Geraldine Ferraro seems clearly to be there, and it remains to be seen whether it will be realized by her actual performance during the campaign. Additional data will be collected during the campaign to gauge her effect more directly, but attention will have to be devoted to analyzing them by party. One immediate consequence of Ferraro's selection has been to give pause to Republican strategists trying to devise a way to deal with her personally and with her role in the campaign. One attempt to blunt the effect of her selection was raised in discussions of the financing of her 1978 Congressional campaign and the personal finances of her and John Zaccaro, her husband. The press's preoccupation with this story in the slow news period leading up to the Republican convention blunted the full effect of her first solo campaign swing to the West. Most of the problem was brought on by confusion and/or lack of communication between Ferraro and Zaccaro.

But the incident also highlights the difficulties the press has had in dealing with the more novel elements of her candidacy and some of the tensions between following the letter and the spirit of the campaign finance laws. Heretofore, most political spouses had little in the way of independent income, and it was usually reported in a jointly-filed income tax return. The practice of providing copies of these returns, not an actual requirement, presented little problem. Because Zaccaro and Ferraro filed separately, however, two disclosure decisions had to be made, and his had to be negotiated semi-publicly.

After discussing her financial affairs for almost two hours with reporters, Ms. Ferraro and her staff hope this episode is behind them and they can get on with regular campaigning. Because of the length of the disruption, it is fortunate for the Democrats that the campaign started so early. The entire incident seems to have come up and gone before Labor Day, but it may well give temporary pause to future female candidates and their spouses, as the controversy has inevitably established new standards for disclosure of personal and financial activities.

Tracking the Campaign Through Election Day

With the widespread availability of public opinion surveys these days on television and in the newspapers, there is a greater opportunity than ever to assess the candidates' performance and track their relative standing between now and election day. There are some general patterns to these data which can be observed in any election, as well as some key indicators which should provide a prospective guide to the eventual outcome of this one on November 6.

It is customary in American politics for the party out of power to hold its presidential nominating convention first. The strategic importance of this is to give them more time to organize for the campaign and to develop an identity for their team of candidates. With the advent of televised journalism and coverage of the conventions, this scheduling gives them a tremendous recognition boost from one week of constant exposure.

The incumbent's party, on the other hand, generally holds its convention relatively close to the traditional Labor Day start of campaigning. Their candidate begins with an experienced staff, has less need for the media exposure, and has the opportunity to preserve a "presidential" image on the job without undue attention to direct campaigning.

There are consequences of this scheduling in the "trial heat" data on candidate preference collected across the summer in the presidential years, and they are shown in Table 2 for the last six elections. Whatever the relative standing of the candidates before the first convention, the ticket for the party out of power usually rises in the public polls just after its convention. The only exception has been the 1972 Democratic convention which nominated George McGovern. In the Gallup data currently available, Mondale has moved from about 6 percentage points behind Reagan to about 2 points ahead.

But the Republican convention is yet to come, and there should be a corresponding boost in Reagan's fortunes, as measured by this question, at the end of August. As the data in Table 2 show, this has been the case each time except in 1964. Lyndon Johnson's lead was so great going into the convention, there was little possiblity of increasing it. Given these data, the "true" initial standing of the two tickets will not be known until late August. Reagan should be in the lead then. If his percentage-point margin lead is in the teens, then the Democrats may be in serious trouble. If it is 10 percentage points or less, then Mondale and Ferraro have a reasonable chance of catching up.

The best way to track the relative performance of the two tickets during the campaign is by gauging the defection rate of the weakly identifying Democrats. In June, Reagan was attracting about one-quarter of them, an amount sufficient to secure his victory. Mondale will have to reduce that number to something closer to a historical level of about one in eight or ten in order to have a chance. The preferences of self-described independents will be of equal significance to each side and will also provide a guide to the candidates' respective fortunes.

A surrogate measure for the distribution of candidate preference by party identification in the published polls is union membership. This group has historically voted Dem-

TABLE 2. The Effect of Timing of the Convention on the Margin for Presidential Candidates*

	FIRST CONVENTION				SECOND CONVENTION			
		Percentage Point Difference for Party's Candidate				Percentage Point Difference for Party's Candidate		
Election Year	Party Out of Power	Pre-Convention	Post-Convention	Change	Party In Power	Pre-Convention	Post-Convention	Change
1964	Republicans	−36	−28	+ 8	Democrats	+36	+36	0
1968	Republicans	+ 2	+16	+14	Democrats	−16	−12	+ 4
1972	Democrats	−19	−26	− 7	Republicans	+26	+34	+ 8
1976	Democrats	+17	+33	+16	Republicans	−22	−15	+ 7
1980	Republicans	+ 3	+16	+13	Democrats	−16	+ 1	+17
1984	Democrats	− 6	+ 2	+ 8	Republicans	?	?	?

*The source of these data is the Gallup Organization, Inc. as reported in *The National Journal* (August 4, 1984), p. 1496. The margins represent percentage-point differences to the standard Gallup question: "Suppose the presidential election were held today. If 'A' were the Democratic candidate and 'B' were the Republican candidate, which would you like to see win?" The differences are calculated on the basis of expressed candidate preference without any allocation of undecideds or preferences for other candidates. Sometimes there was more than one survey conducted in the period between the two conventions, so the post-convention margin after the first convention does not always correspond to the pre-convention margin before the second convention.

ocratic by about three to one. In 1980, a majority supported Ronald Reagan. Across the summer, Reagan has maintained the support of close to half of these respondents, again a sufficient number to ensure his victory. If this proportion decreases substantially, it could signal rising Democratic fortunes. If the proportion persists at this level, it strongly suggests the reelection of Ronald Reagan.

August 1984

Actual and Projected Economic Indicators

seasonally adjusted

SERIES FORECAST BY THE ASA-NBER PANEL															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	Actual							Projected					Act'l.	Projected	
	1982:4	1983:1	1983:2	1983:3	1983:4	1984:1	1984:2	1984:2	1984:3	1984:4	1985:1	1985:2	1983	1984	1985
GROSS NATIONAL PRODUCT*	3,110	3,174	3,267	3,347	3,432	3,553	3,646	3,610	3,689	3,771	3,850	3,927	3,305	3,650	3,970
GNP IMPLICIT PRICE DEFLATOR* (index, 1972 = 100)	210.3	212.9	214.3	215.9	218.2	220.6	222.3	223.0	226.0	228.9	231.8	235.0	215.3	224.7	236.8
CORPORATE PROFITS AFTER TAXES*	100.8	102.6	123.4	142.6	141.4	150.6	NA	151.5	157.0	161.0	164.0	166.8	127.4	155.0	168.3
UNEMPLOYMENT RATE (percent)	10.60	10.37	10.10	9.40	8.47	7.87	7.47	7.70	7.50	7.40	7.30	7.25	9.58	7.60	7.15
INDUSTRIAL PRODUCTION (index, 1967 = 100)	135.3	138.5	144.5	151.8	155.5	159.8	162.9	163.0	165.0	167.0	168.0	169.0	147.6	164.0	170.0
NEW PRIVATE HOUSING UNITS STARTED (millions)	1.269	1.643	1.690	1.782	1.699	1.968	1.907	1.820	1.765	1.700	1.685	1.650	1.704	1.800	1.630
CONSUMER PRICE INDEX (% change from prior quarter or year)	1.6	0.3	4.3	4.2	4.4	5.0	3.7	4.3	5.0	5.2	5.3	5.6	3.2	4.6	5.5
3-MONTH TREASURY BILL RATE (%)	7.94	8.08	8.42	9.19	8.79	9.13	9.84	9.80	9.89	10.20	10.10	10.28	8.62	9.75	10.40
NEW HIGH-GRADE CORPORATE BOND YIELD (percent)	12.22	11.99	11.57	12.68	12.76	12.94	NA	13.45	13.40	13.55	13.70	13.70	12.25	13.30	13.70
GNP IN 1972 DOLLARS*	1,479	1,491	1,525	1,550	1,573	1,611	1,640	1,619	1,633	1,646	1,661	1,674	1,535	1,626	1,674
PERSONAL CONSUMPTION EXPENDITURES (1972 $)*	976	982	1,006	1,016	1,032	1,044	1,062	1,057	1,066	1,074	1,082	1,091	1,009	1,061	1,093
NONRESIDENTIAL FIXED INVESTMENT (1972 $)*	161.5	161.6	165.3	172.6	184.5	193.3	202.6	190.0	193.8	197.0	199.0	202.0	171.0	192.0	203.7
RESIDENTIAL FIXED INVESTMENT (1972 $)*	40.8	46.2	53.4	57.2	57.8	60.6	62.0	60.6	60.9	59.0	59.3	58.0	53.7	60.0	58.2
CHANGE IN BUSINESS INVENTORIES (1972 $)*	−24.6	−16.5	−6.1	0.9	7.2	31.6	21.5	17.7	17.0	16.0	16.0	15.0	−3.6	19.6	15.0
NET EXPORTS (1972 $)*	24.1	22.9	13.6	11.9	2.0	−8.3	−10.0	−8.0	−8.0	−7.5	−6.0	−5.0	12.6	−8.0	−6.0
FEDERAL GOVERNMENT PURCHASES (1972 $)*	124.8	119.0	117.2	115.6	113.0	112.2	123.7	121.5	125.0	127.0	128.0	130.0	116.2	122.0	130.0
STATE AND LOCAL GOVERNMENT PURCHASES (1972 $)*	175.8	175.3	175.2	176.4	175.8	177.3	178.7	178.0	180.0	181.0	181.8	182.2	175.7	179.0	183.0

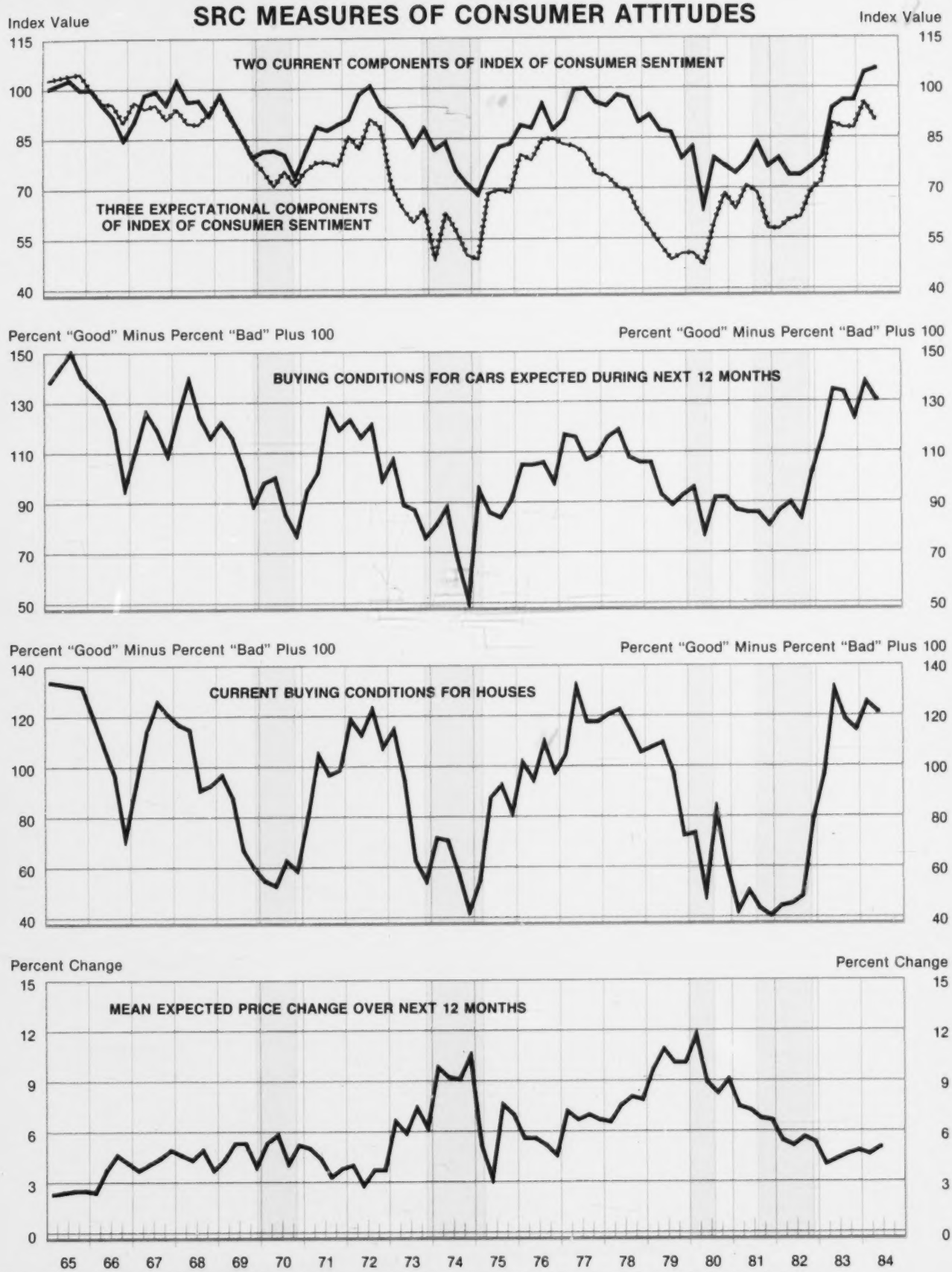
SERIES FROM THE CURRENT-DOLLAR GNP ACCOUNTS															
ECONOMIC INDICATOR	Quarterly Data												Annual Data		
	1981:3	1981:4	1982:1	1982:2	1982:3	1982:4	1983:1	1983:2	1983:3	1983:4	1984:1	1984:2	1981	1982	1983
GROSS NATIONAL PRODUCT*	3,009	3,028	3,026	3,061	3,080	3,110	3,174	3,267	3,347	3,432	3,553	3,646	2,958	3,069	3,305
PERSONAL CONSUMPTION EXPENDITURES*	1,877	1,892	1,931	1,961	2,001	2,046	2,070	2,142	2,181	2,230	2,277	2,327	1,849	1,985	2,156
GROSS PRIVATE DOMESTIC INVESTMENT*	505.8	481.7	436.2	431.2	415.9	376.2	405.0	449.6	491.9	540.0	623.8	631.5	484.2	414.9	471.6
NET EXPORTS*	24.8	31.7	27.7	35.5	6.6	6.3	19.6	−6.5	−16.4	−29.8	−51.5	−58.0	28.0	19.0	−8.3
GOVERNMENT PURCHASES*	601.3	622.7	630.9	633.7	656.3	681.0	678.8	682.2	689.8	691.4	704.4	746.1	596.5	650.5	685.5
DISPOSABLE PERSONAL INCOME*	2,079	2,110	2,132	2,157	2,196	2,238	2,261	2,303	2,367	2,429	2,502	2,558	2,042	2,181	2,340
PERSONAL SAVING RATE* (% of disposable income)	7.0	7.6	6.7	6.3	6.1	5.8	5.7	4.2	5.0	5.3	6.1	6.0	6.7	6.2	5.0

Note: (1) All data are at annual rates and in billions of current dollars unless otherwise indicated. (2) To facilitate comparison and evaluation of forecasts, both actual data, released in late July, and projected data, released by ASA-NBER in June, are displayed for second quarter 1984.

Sources: Projections: American Statistical Association – National Bureau of Economic Research panel of forecasters.
Actual Data: U.S. Departments of Commerce and Labor, Board of Governors of the Federal Reserve System.

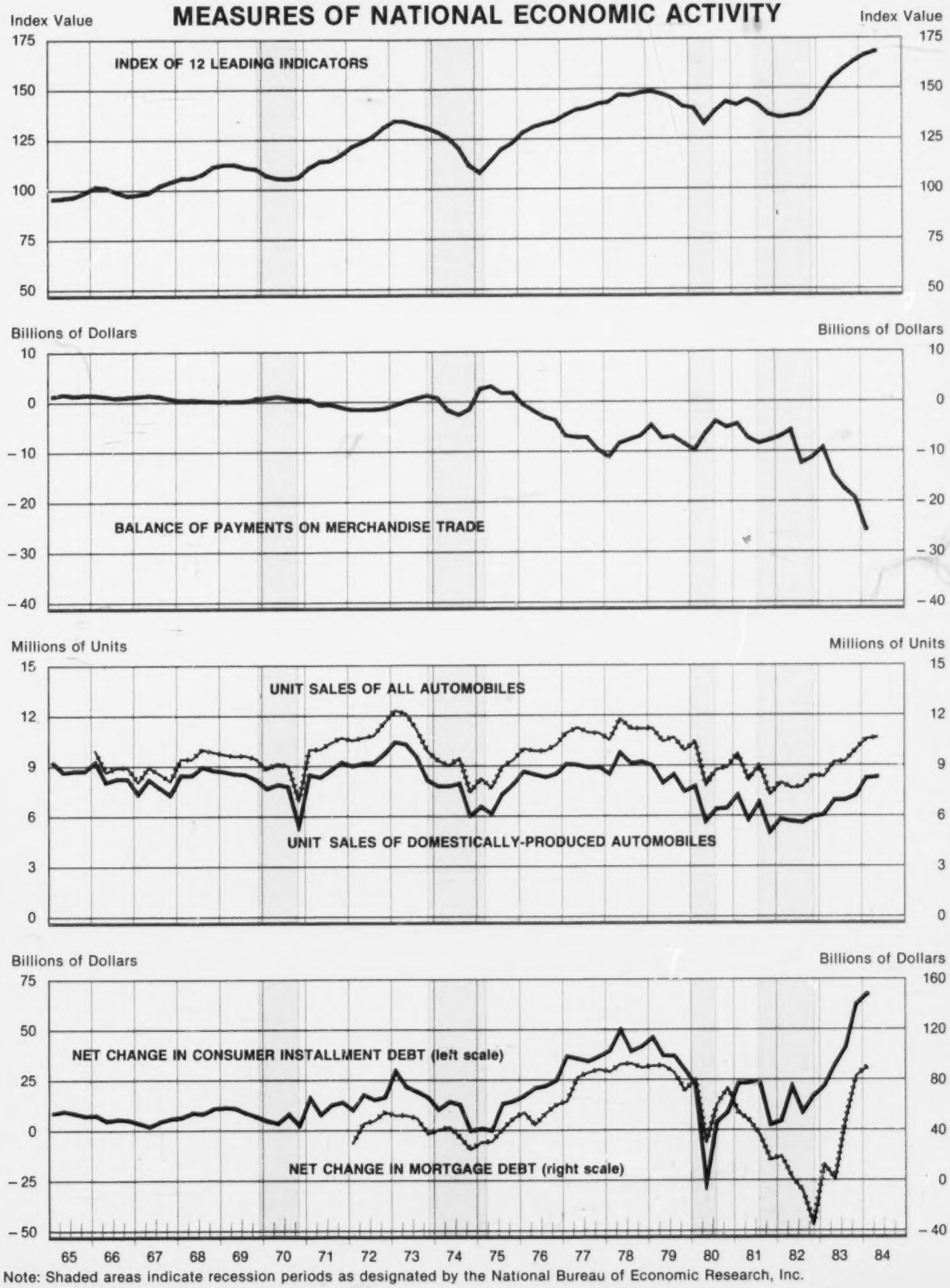
*Substantial revision of the data for variables marked with an asterisk has occurred since the last printing.

SRC MEASURES OF CONSUMER ATTITUDES



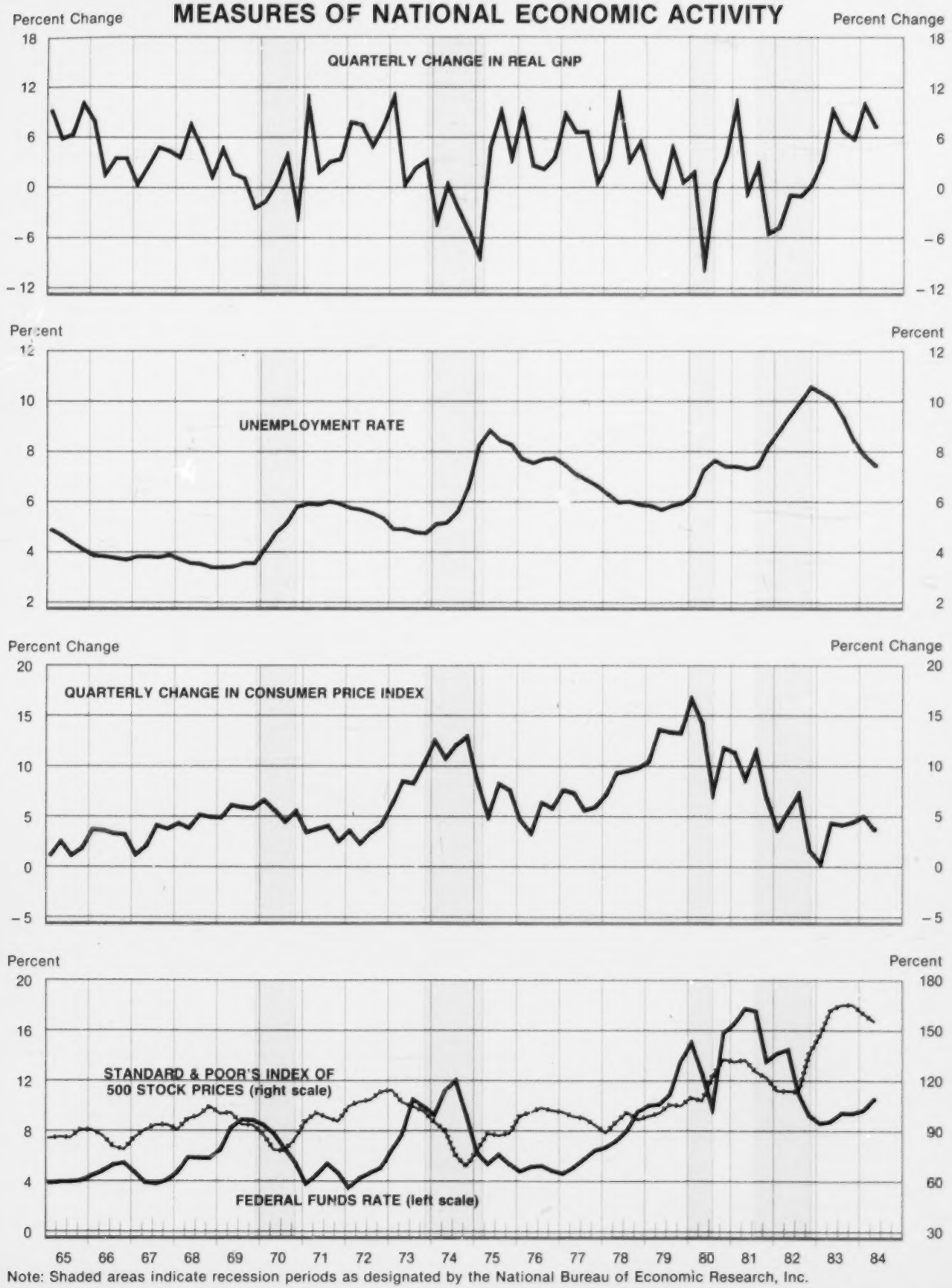
Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



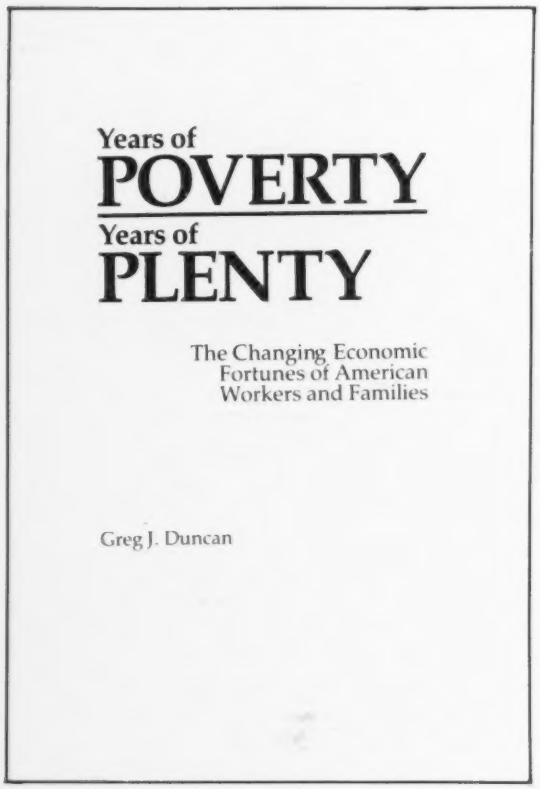
Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

MEASURES OF NATIONAL ECONOMIC ACTIVITY



Note: Shaded areas indicate recession periods as designated by the National Bureau of Economic Research, Inc.

Sheds new light on welfare use and family economics in America...



PAPERBOUND EDITION NOW AVAILABLE

Order from: ISR Publications Sales
Institute for Social Research
The University of Michigan
P. O. Box 1248
Ann Arbor, MI 48106-1248

All orders from individuals must be prepaid.

This volume explores the economic ups and downs experienced by a large and representative sample of American families from 1969 through 1978. Author Greg J. Duncan—along with colleagues Richard D. Coe, Mary E. Corcoran, Martha S. Hill, Saul D. Hoffman, and James N. Morgan—has distilled ten years of economic, behavioral, and attitudinal data from ISR's ongoing Panel Study of Income Dynamics.

This long-term perspective on families reveals some previously unobserved patterns in American life, contradicting much of what has been inferred from cross-sectional survey information about the causes and extent of change in family economic well-being. The data reveal that American households actually undergo an astonishing amount of change in terms of family composition, occupations, income levels, and labor force participation.

The researchers found that welfare touches may lives: One in every four Americans lived in a family that received welfare during at least one of the ten years studied. But the findings also showed that there is substantial turnover among the poverty population, contradicting the popular notion that poverty tends to be an inescapable, self-perpetuating condition.

Exploring the dynamics of poverty and welfare use, the researchers found that changes in family composition are crucial explanatory factors, with divorce or separation imposing a devastating economic cost in the impoverishment of women and their children.

Other major findings include an assessment of changes in the economic status of black working men over the past two decades, and an examination of the unchanging wage gap between working women and their male counterparts.

The results and conclusions from these unique data have important implications for social science theory and for the social and economic policies that are based on that theory.

Contents

- An Overview of Family Economic Mobility
- Dynamics of Poverty
- Dynamics of Welfare Use
- Dynamics of Work Hours, Unemployment, and Earnings
- Recent Trends in the Relative Earnings of Black Men
- Do Women "Deserve" to Earn Less Than Men?
- References
- Glossary/Index

1984 / 200 pages / ISBN 0-87944-285-9 / cloth $24 / paper $14

ECONOMIC OUTLOOK USA
SRC—P.O. Box 1248
Ann Arbor, MI 48106

Second Class Postage
Paid at Ann Arbor, MI

CHERYL WALDMAN 6093
CONGRESSIONAL
INFORMATION SERVICE
4520 EAST-WEST HY
BETHESDA MD 20814